Editorial
Restoring healthy growth: policies for higher and more inclusive productivity

A pickup in global growth remains elusive, almost eight years after the financial crisis erupted. The recovery in advanced economies is still muted, particularly in the euro area and Japan, while growth has slowed in emerging-market economies (EMEs). Trade and investment remain weak, while jobs and wage growth have been disappointing. Financial markets are increasingly volatile as capital searches for both yield and safety. Getting back to healthy and inclusive growth calls for urgent policy response, drawing on monetary, fiscal, and structural policies working *together*: On the one hand, demand policies alone will not restore sustainable growth; but on the other hand, policies to strengthen competition and innovation, spur job creation, and repair financial systems to fund investment will only yield results if there is enough demand.

This 2016 *Going for Growth* report underscores the importance of synergies among policies in designing policy packages. Policy coherence across a broad range of reform objectives such as product market competition, labour mobility and financial market robustness is critical to create an environment conducive to innovation and resource reallocation, which are crucial to reverse the widespread slowdown in productivity and the rise in inequality.

Productivity – a central ingredient in the pursuit of wellbeing – has been decelerating in a vast majority of countries, with the slowdown going back to around 2000, at least in advanced economies. While this may partly reflect measurement issues, a common set of unsettling trends lie behind the aggregate slowdown: the dispersion of productivity growth across firms within industries, the decline in the growth rate of investment in knowledge-based capital, and the reduction in the pace of business creation. These trends are outcomes from problems in the basic policy environment – market competition and innovation, labour market institutions, financial structure and robustness – which also contribute to unfavourable trends in income distribution.

In addressing the productivity and inclusiveness challenges, governments need to keep in mind the basic policies that underpin these developments, and hence the need for coherent policy packages. Start with narrowing the productivity gap across firms, which requires a better diffusion of innovations from leading to lagging firms. Since leading firms are mostly multinationals, the intensity of cross-border connections via trade, FDI, global value chains and the mobility of skilled labour is crucial for the diffusion of knowledge and technologies from these globalised “frontier” firms to national firms.

Giving international trade a fresh boost requires that recent multilateral agreements in this area be forcefully implemented but also that efforts be made to further reduce barriers in the form foreign ownership restrictions or preferential treatments of domestic suppliers with respect to public procurement, taxes and subsidies. In several EMEs – notably Brazil, India and Indonesia – barriers to infrastructure investment need to be addressed to significantly improve the transport and logistic services that underpin cross-border trade.

Next, consider improving knowledge diffusion and making the most of new technologies, which necessitates synergic investments by lagging firms in various forms of knowledge-based capital such as R&D, skills and organisational know-how. Despite the need to revive investment in knowledge-based capital, the incidence of innovation policy reforms appears to have steadily fallen in recent years, as documented in this report.

Furthermore, for reforms in the area of innovation to pay off, firms need the right incentives to strive for the development of new and better-quality products at lower costs. Strong product market competition provides such incentive. In this regard, the decline in business start-ups in advanced economies could be a sign that barriers to entry, including through the financial system, have been creeping up and hence that the strength of competition is eroding.

Re-examination is needed of competition policy, bankruptcy legislation and product market regulations to facilitate entry and exit, and to provide a level playing field between new firms and incumbents. As emphasised in this report, pro-competition reforms are particularly needed in services where the scope for both job creation *and* productivity gains remains large. This is especially true for Germany, Japan and Korea where the gap in productivity between services and manufacturing is the largest among advanced economies, but also for China as the economy goes through a challenging rebalancing from manufacturing to services.

Deeper global integration and the growing reliance on intangible forms of capital stresses the importance of collective policy approaches in the areas of competition law enforcement, regulatory harmonisation, basic research and the taxation of mobile capital. One major achievement in 2015 has been the global agreement on a list of measures to limit tax avoidance by multinationals through the so-called Base Erosion and Profit Shifting (BEPS) action plan elaborated under the auspices of the G20 and the OECD.

In addition to fostering competition, product market reforms also facilitate the reallocation of resources from low- to high-productivity firms. The efficiency of resource allocation would be further enhanced with measures to reduce barriers to labour mobility, notably those linked to housing markets. In turn, to ensure that resource reallocation truly serves wellbeing, workers need to be better equipped and offered real opportunities to adapt skills. Adult learning programmes should thus focus more strongly on skills complementarity with technological progress so as to help to reduce skills mismatch and to facilitate adaptation to the rapid change in the nature of tasks associated with specific jobs. Improving the matching of skills to jobs raises productivity and reduces inequality.

Sustained growth and job creation are the best ways to improve income distribution, since the low- income and less-skilled bear the brunt of economic downturns. A challenge for several advanced economies – in particular those facing persistently high unemployment such as France, Italy and Spain – is to shift social protection from specific jobs to individuals so as to better support the process of jobs and firms turnover that underpins dynamic, growing economies. Reforms in this area will help to improve job opportunities for youth and low-skilled workers, particularly hard hit by unemployment. For emerging economies, stronger social protection is needed to reduce informality and inequality, while fostering domestic consumption.

Strong employment growth is critical to ensure that growth benefits all segments of society, but it is not sufficient. In several countries, a large and rising share of the growth benefits have accrued to high-income households, while income at the bottom has been stagnant for many years. In the United Kingdom and in particular the United States, reforms to provide better access to high-quality education for students from disadvantaged backgrounds combined with measures to make the tax system more efficient and equitable would help to make growth more inclusive. In some countries such as Italy and Korea, household income has not kept up with GDP gains over the past two decades. Chapter 3 of this report explores the channels through which the income generated through GDP is transmitted to households.

Given the breadth and evolving nature of the growth and inclusiveness challenges facing advanced and emerging economies, the slowdown in the pace of structural reform documented in this report is deeply concerning. While the pace of reform should be accelerating to restore sustainable and equitable growth, the pace of reforms appears to have steadily declined since 2011-12. While some countries have made considerable efforts, many have taken very little action and countries with ambitious reform programmes, such as in India, Japan and Turkey face significant political challenges and the risk of losing momentum. Progress has been made on the G20 action plan to raise reform efforts, but much remains to be fully implemented.

Given the weak demand environment, structural reform packages that promote productivity should focus as well in design on maximising short-run growth gains. Chapter 2 of this report reviews the issues and evidence on the impact of reforms introduced in a difficult economic conjuncture for their outcomes in terms of both productivity and income distribution. Reform strategies that put more weight on shifting the composition of public spending towards investment, facilitating the entry of new firms in services, and reducing barriers to labour mobility are most likely to boost activity in the short term, with the support of demand policies and a repaired financial sector. More vigorous reform efforts from euro area countries with a large current account surplus would also help to ensure that the current growth pick-up in that region does not succumb to internal divisions and external headwinds. All countries contributing collectively to reform efforts and to supportive demand improves the prospects for a return to higher productivity and more inclusive growth both at home and in the global economy.

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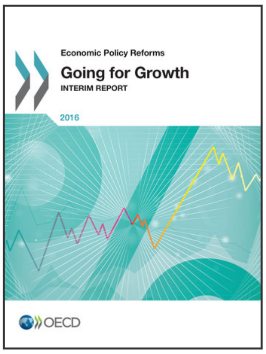

From:
Economic Policy Reforms 2016
Going for Growth Interim Report

Access the complete publication at:
https://doi.org/10.1787/growth-2016-en

Please cite this chapter as:

OECD (2016), “Editorial: Restoring healthy growth: policies for higher and more inclusive productivity”, in *Economic Policy Reforms 2016: Going for Growth Interim Report*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/growth-2016-1-en

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