EDITORIAL

THE B-MINUS WORLD ECONOMY: INVESTMENT IS KEY TO GETTING A BETTER GRADE

The economic recovery from the global financial and economic crisis that broke out in 2008 has been unusually weak. Global growth has consistently been slower than the average pace during the dozen or so years before the global financial crisis. The failure to achieve a stronger cyclical upswing has had very real costs in terms of foregone employment, stagnant living standards in advanced economies, less vigorous development in some emerging economies, and rising inequality nearly everywhere.

In this Economic Outlook we project that global growth will strengthen gradually to approach its past average pace by late 2016. Growth is expected to be shared more evenly across regions of the world, with external imbalances generally smaller than they were in the run-up to the global crisis. Labour markets are gradually healing in the advanced economies. Risks of deflation have receded. Yet, we give the global economy only the barely passing grade of B-.

Why the dissatisfaction? To begin with, our starting point is inauspicious. The first quarter of 2015 saw the weakest global growth since the crisis. The United States experienced a particularly sharp dip, but a number of other advanced economies shrank during the quarter, and growth in China slowed down more than expected. We see this weakness at the beginning of the year as largely the result of temporary factors. The boost to consumption from lower oil prices is still expected to come through in oil-importing countries, where demand will also be spurred by the widespread monetary easing (often accompanied by currency depreciation) in countries accounting for more than 50% of world GDP. A generally neutral fiscal stance in most large economies will not be a drag on growth, unlike in the previous few years.

But even if we are right about the transitory nature of the latest bout of weak growth, the outlook is not satisfactory. Despite tailwinds and policy actions, real investment has been tepid and productivity growth disappointing. By and large, firms have been unwilling to spend on plant, equipment, technology and services as vigorously as they have done in previous cyclical recoveries. Moreover, many governments postponed infrastructure investments as part of fiscal consolidation.

This Outlook takes a detailed look at investment, concluding that the slow rate of private investment is largely explained by subdued (actual and expected) demand, both at home and globally. This demand weakness has hindered investment growth, which in turn has held back employment, wages, and consumption. On the supply side, sluggish investment has undermined the rate of growth of potential output – the capacity of economies to increase living standards, make good on future obligations to citizens, and repay debt – via a slower rate of increase of the capital stock and a slowdown in the diffusion and embodiment of technical change. The world economy remains stuck in a low-level supply-demand equilibrium environment.

Boosting the performance of the global economy requires jumping to a higher growth equilibrium with more investment, that creates more employment, jobs, and consumption demand, which ratifies the higher rate of investment, leading to the beneficial supply-side outcome. At least some of what we see as needed for such a jump to a high-level equilibrium is in prospect, given macro-policies and global demand balance. In our projections, fixed investment growth in the OECD region picks up to 4% next year, the highest rate since the crisis. But whether investment accelerates in line with our projections is a key question hanging over the improving outlook that we depict. Moreover, even if it does, this would still be insufficient to deliver the strong global growth in the near term needed to increase employment and reduce inequality; potential output growth would still look anaemic compared to past decades.

So, more than demand-oriented macro policies are needed to generate a strong and durable boost to investment. Reducing policy uncertainty would help, such as a tone-down of fiscal brinksmanship in the United States, favourable resolution of Greece’s status vis-à-vis the euro area, realistic medium-term fiscal path in Japan, and greater transparency of financial systems in emerging economies. Progress on reducing financing constraints in the euro area through attention to non-performing loans could cement more positive business sentiment there. Clear signals this year at COP21 on coordinated international action to combat climate change could be an important incentive to underpin a surge in investment, with benefits for demand, innovation and environmental sustainability.

Structural policies have a central role to play to achieve more satisfactory and sustained investment growth. Restrictive product market regulation impedes the growth of the capital stock in OECD economies. FDI restrictiveness (and corruption) affect quantity and quality of cross-border investment. In the European Union, attention to disparities and complexities in regulation of network services industries, as proposed in the Investment Plan for Europe, would support investment to complete the Single Market. In some emerging markets cost-benefit analysis would improve the returns to investment, making it a more sustainable underpinning for growth

The Economic Outlook calls on countries to adopt balanced policy packages with mutually reinforcing monetary, fiscal and structural policies. Collective action with positive spillovers can boost the global economy to the higher-growth equilibrium with stronger investment, more employment, and a greater capacity to improve living standards for all. More robust global growth will make countries and the global economy more resilient to salient risks such as financial instability. Expanding employment and strengthening public finances are pathways to equality of opportunity. The world economy is muddling through with a B-minus average, but if homework is not done and with less than average luck, a failing grade is all too possible. On the other hand, how to get the A is known and within reach.

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