

# New Approaches to Economic Challenges [B13]

## OECD @ 100

### THEME OF THE PROJECT

*The legacy of the Great Recession lingers...*

More than seven years since then 2008 crisis the global economy is still running in a low gear. Global growth has been more than 1 percentage point below the 2000-07 period, unemployment is set to stay above pre-crisis levels in many economies, while private business investment is still just idling along.

*... and long-term challenges are becoming more salient*

In addition, challenging trends that pre-dated the crisis and likely to continue into the future. There are tensions and potential imbalances that can emerge from developments in a number of areas such as demography, technology, skills requirements, and increasing integration in the context of fiscal constraints, rising environmental pressures and threats to economic stability.

### RESULTS OF THE WORK STREAM

*Future growth rates will likely be lower...*

In the period to 2060, global growth prospects will be mediocre compared to the past -- reflecting ageing, slower human capital accumulation and decreasing scope for catch up by non-OECD countries as their living standards converge towards those of the OECD. GDP in the OECD and the emerging G20 countries will likely grow on average by 2.7% in 2010-2060, compared to 3.4% in 1996-2010. Global GDP is expected to grow by 3% per annum 2010-2060. Faster growth in the emerging world will continue to shift the global economic balance. To sustain this lower, but still significant growth rate, deepening of human capital and a greater focus is needed on productivity driven by skilled-biased technical change.

*... the global economy will be more integrated...*

Global trade integration will continue and deepen, albeit at a slower pace than in the

past. Non-OECD countries will capture a growing part of global trade and the trade and industrial specialisation of emerging countries will look increasingly like those of the OECD. Economic convergence will alter patterns of economic migration towards OECD countries with the risk of drying up a possible source of offset to ageing labour forces.

*... and inequality will be higher ...*

The growing importance of Knowledge Based Capital (KBC) will exacerbate income disparities based on skills. Earnings disparities may continue to rise sharply if well-designed redistributive policies are not implemented and private or public investment in higher education is not stepped up.

*... leading to fiscal challenges ...*

Greater demands on tertiary education, social insurance and pension systems, as well as health care from increasing demand for skills and ageing populations, may threaten fiscal stability.

*... and environmental pressures will intensify*

Without decisive action, environmental degradation will prove to be a critical challenge in the medium to long term and may hamper growth before 2060. The impact of environmental damages may reduce global GDP by 1.5% and by as much as 5% in South and South-East Asia.

### NEW APPROACHES

*An integrated modelling approach to developing long-term scenarios*

The OECD@100 used a novel/multifaceted modelling approach to project current and prospective future threats to the global economy. Forward-looking scenarios are constructed using a set of interacting modules, each describing one or several key variables (this includes growth, emissions, climate and environmental damage modules, trade and specialisation module and a wage inequality module) and

feeding into the others, under a common set of growth trajectories. While this approach is still largely based on the extrapolation of past trends, it has produced greater awareness and insights into the various policy linkages of an inter-connected global economy.

### POLICY IMPLICATIONS

The projected changes in the world economy help structure thinking about the future and the consequent demands on policies. Of course, many of the crucial issues of the past and present will likely remain in the period to 2060. For instance, policies that enhance productivity, support equity, ensure robust public finances, and discourage overuse of natural resources, will be just as important in the future as they are today. Similarly the need to strengthen and enhance economic and political institutions will remain.

*The changing economic environment spurs the need for innovative policies ...*

A changing economic environment and uncertainty around future developments will likely shift the way economic policies should be pursued. For instance, as growth is increasingly driven by knowledge and skills, the growth process itself may generate tensions such as inequalities. At the same time, the scope for domestic policy to address such issues may be reduced, as the fiscal domain is squeezed, and traditional redistributive policies become more costly and difficult to implement because of increasingly mobile tax bases and cross-country spill-overs.

*... to support more inclusive growth ...*

Policies to encourage growth in a knowledge-intensive economy should involve reviewing intellectual property rights approaches and appropriate product and labour market settings that facilitate firm entry and exit. Furthermore, these reforms need to be complemented with focused education policies that generate high social returns and encour-

age life-long learning in the context of ageing societies. Better-targeted redistribution through the tax and benefits system, in addition to policies that promote equality of opportunity, reflecting the changing structure of the workforce, can potentially improve equity outcomes.

*... address the rising costs of climate change*

Front-loaded environmental policies can reduce the future costs of environmental damages. While deeper international integration of trade and investment can improve risk-sharing of potential climate damages.

*... and ameliorate fiscal pressures ...*

Future uncertainties related to demographic changes and productivity trends, suggest fiscal systems need to be made more resilient to shocks. Efficiency-boosting structural reforms and diversifying funding sources away from public finance will lessen the pressure on the treasuries of OECD countries. There is a dilemma in reforming the tax system. Taxes need to be levied increasingly on immobile tax bases, as the cost of taxing mobile intangible inputs increases. However this is at odds with the increasing size and role of intangibles in the future economy.

*... all with better international cooperation in an increasingly multipolar world*

The need for improved and enhanced international policy cooperation and coordination underpins the majority of the above policy areas. Economic challenges (including among others research efforts, intellectual property rights protection, productivity spillovers, mobile taxable assets, environmental degradation) in the future will not be constrained by political borders. Therefore, boosting cooperation in a wide number of areas will be crucial, even though the shift towards a multipolar world is likely to make cross-country cooperation more challenging in view of differences in priorities and preferences in the global economy.

### PROJECT PAPER

- Braconier, H., Nicoletti, G., Westmore, B., (2014), "Policy challenges for the next 50 years", OECD Economic Policy Paper, N:9, OECD, Paris