

Editorial

Avoiding the low-growth trap

The widespread deceleration in productivity since the crisis could presage the beginning of a new low-growth era. The global economy's momentum remains sluggish, heightening concerns that there has been a structural downshift in growth rates compared with pre-crisis levels. These concerns, already prevalent among advanced OECD countries for some time, now encompass emerging-market economies and are fuelled also by high unemployment and falling labour force participation in many countries.

Some of the factors behind the productivity slowdown have yet to be fully understood, not least the role and nature of technological progress. But one worrying development is the marked slowdown in global trade activity relative to world production. Aside from its fundamental role as a vector of technology and knowledge diffusion, international trade boosts productivity through stronger competition pressures on domestic markets. And trade-related concerns are magnified by subdued investment in new plant, machinery and equipment as well as in less tangible assets such as research and development or new business processes and workforce training, which are needed to make the most of new technologies. Indeed, current business investment rates in most advanced economies are below what would be needed to sustain higher trend growth rates. In several emerging-market economies – notably Brazil, India and Indonesia – infrastructure investment is not sufficient to support high rates of industrialisation and urbanisation, hampering potential growth.

In addition, many advanced countries are still plagued by persistently high unemployment and, even worse, a high incidence of long-term unemployment. The risk is that, as time goes by, maintaining the long-term unemployed in the labour force and facilitating their return to work become increasingly difficult. The risk of higher structural unemployment may in fact be materialising in places such as Southern euro area countries. In the United States, protracted labour market weaknesses have led to a substantial decline of labour force participation since 2008. While in many rich countries the increase in youth non-employment rates since the start of the crisis is largely accounted for by a rise in education and training enrolment, the share of youth not in employment, education or training has also risen substantially or has remained high. The latter phenomenon is also prevalent among many emerging-market economies, in particular India, Turkey, South Africa and, to a lesser extent, Mexico. The result is a potentially huge loss of human capital, which further undermines productivity prospects.

Weak global demand, pressures from budgetary consolidation and remaining dysfunctions in financial markets are exerting a drag on trade, investment and job creation, notably among smaller firms whose access to external sources of funding is often critical. The current pace of activity thus reflects a combination of both cyclical weaknesses and structural deficiencies in policy settings, although the relative contribution of these factors is difficult to assess. Clearly, addressing financial market failures and restoring healthy banking-sector balance sheets – particularly in the euro area – remain top priorities. This would do much to boost the impact of structural reforms in other

complementary areas, which are also needed. For instance, firms' incentives to invest in new markets and technologies as well as to seek more efficient ways to allocate capital and labour resources could be enhanced by further reductions in regulatory barriers to competition along with greater openness to foreign trade and investment. Such reforms could also help foster job creation if accompanied by measures to facilitate wage adjustments and reduce labour costs, including further shifts in taxation from labour towards consumption and – even better from an equity perspective – immovable property and inheritance.

Still, faster job creation is unlikely to be enough to bring employment rates back to pre-crisis levels, let alone to levels that would offset the impact of population ageing in advanced economies. Boosting employment also requires that more attention be given to growing skills mismatches and low labour force participation, especially among groups such as women and older workers. In most emerging-market economies – China being a notable exception – a key issue is to bring more workers into formal sector activities. In most cases, reducing informality requires rolling-out social protection to all workers, using programmes that best take into account country-specific characteristics and institutional capacities. In countries such as Chile, Indonesia, South Africa and Turkey, reforms of labour market regulation or wage bargaining institutions are also needed to lower hiring and firing costs and prevent low-skilled workers from being priced out of jobs in the formal sector.

This report reviews the main growth challenges facing OECD and major non-OECD countries – regrouping them according to the common nature of the key challenges – and gives an overview of the actions taken over the past two years on policy priorities identified in previous issues of *Going for Growth*. The pace of reforms appears to have slowed somewhat but remains on average well above that observed prior to the crisis in most countries. Southern euro area and, to a lesser extent, Central European countries have continued to be particularly active reformers in areas covered by OECD policy recommendations. This should not come as a surprise insofar as a number of these countries have been under market pressures or direct financial assistance programmes. Importantly, considerable action has been taken in areas such as labour market regulation, collective bargaining and welfare systems, which in the past have proved particularly difficult to reform. Reforms of pension systems and early retirement schemes, as well as of active labour market programmes, have also ranked highly on the policy agenda in many other countries facing low employment rates.

In the countries most severely affected by the crisis, long-overdue labour market reforms had become necessary to restore competitiveness and help narrow external imbalances. However, given the particularly difficult context in which this adjustment has taken place, it has not been without painful consequences for many workers and their families. In order for them to see benefits in the form of improving job opportunities and higher real incomes, labour market reforms must be matched by more vigorous actions to boost product market competition.

One special feature of this report is to assess the progress countries have made in the past five years in reducing regulatory barriers to competition in product markets. While governments have continued to move towards more competition-friendly regulation, progress has, alas, been modest except for a few cases. In particular, competition in network industries and especially professional services continues to be held back by regulatory barriers to entry. Also, where regulatory settings have been improved, the legislated changes need to be fully implemented to ensure that they effectively ease the administrative burden on enterprises and promote the entry of new firms.

Pursuing reform in services is all the more important given the high growth and employment potential of these sectors. This is particularly evident in OECD countries such as Germany, Japan – as part of *Abenomics*' third arrow – and beyond, not least in China. Services are also critical for a country's competitiveness within global value chains and create over half of value-added in cross-

border trade. In this regard, another policy area where ample scope for further progress remains is global trade liberalisation. Prime candidates for substantial gains include reducing the high tariffs on a range of products in emerging-market countries and removing barriers in services sectors and other sensitive areas such as agriculture and government procurement in advanced countries. The recent agreement on trade facilitation reached in Bali is a step in the right direction, and hopefully will give multilateral trade negotiations a new impetus, but its impact risks being undermined by the proliferation of various trade-distorting measures and covert barriers to foreign investment.

The fact that the pick-up in the pace of reforms since 2010 has been broadly sustained over the past two years is encouraging, considering the difficulty of reforming in a subdued growth environment where the benefits take longer to materialise. And reform fatigue may be exacerbated by concomitant fiscal consolidation. Even so, the intensity of reforms has generally been higher in countries that entered the crisis with large current account deficits than in countries enjoying surpluses.

It is important in the current context to ensure that reform efforts are more even across countries so that the process of rebalancing can be facilitated by stronger global demand. Furthermore, the vulnerability of many emerging-market economies to an eventual tightening of monetary policy or the cooling down of the commodity boom serves as a reminder that the case for structural reforms is also strong there.



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