EDITORIAL

Going for Growth at a Time of Financial Crisis

This fifth edition of *Going for Growth* comes at a time when OECD countries are faced with the most severe financial and economic crises in a lifetime. The still unfolding global crisis and recession have inevitably raised questions about the extent to which markets can be trusted to deliver good outcomes and whether earlier reforms have contributed to make economies more vulnerable. The current crisis in financial markets has uncovered major problems with the functioning of such markets and demonstrated the failures of past regulatory and supervisory structures to ensure market stability. It shows the destructive force of particular developments and imperfections in financial markets that have intensified moral hazard and information deficiencies. These faults are starting to be recognised and countries are beginning to work individually and jointly to identify the best ways to reform regulation of financial markets to address the particular market and regulatory imperfections that led to the current crisis.

However, it is important to emphasise that the debacle in financial markets does not call into question the beneficial effects of recommended reforms of product and labour markets in this report. A number of reforms throughout OECD countries in recent years have demonstrably shown their power to raise employment and productivity, and acting on the reform agenda set out in this report would noticeably strengthen economic performance in the long term. In addition, more flexible product and labour markets are likely to strengthen country resilience to weather future downturns with less disruption to output and employment.

The crisis, nonetheless, has implications for the choice of which structural policies to pursue in the near term. At a time when aggregate demand is well below productive capacity, it is apt to focus on structural reforms that are most likely to raise aggregate demand in the short run as well as aggregate supply in the long run. Indeed, the structure of fiscal packages that have been recently announced or implemented in several OECD countries has also been shaped by concerns of their long-term impact on growth.

This report identifies three broad fiscal/structural reforms that could yield a “double-dividend” at present: increased spending on infrastructure; increased spending on active labour market policy, including on compulsory training courses; and reduction of personal income taxes, notably on low-income earners. In addition, product market reforms that ease entry restrictions and strengthen competition may boost demand in some cases in the short term and increase productivity in the long term.

The special chapter in this report on the long-term impact of infrastructure on GDP per capita comes at the right time, considering the focus of many recent fiscal packages on infrastructure spending to boost the economy. It shows that investment in infrastructure may have positive spillovers throughout the economy. Nonetheless, to get the strongest growth effects from infrastructure investment, it is essential to carefully select projects on the basis of cost-benefit analysis and have in place regulatory structures that ensure competition where it is possible and prevent abuse of market power where competition is not feasible.

Another special chapter on taxation and growth concludes with a ranking across different taxes with respect to their impact on long-term growth. Corporate income taxes are the most harmful, followed by labour income taxes and then indirect taxes, with property taxes the least harmful. Countries currently relying disproportionately on taxes levied on corporate and labour income could therefore raise GDP per capita by shifting their tax base towards goods and services as well as property. This is a promising strategy for the medium and long term, but it may have to be accompanied by supporting measures to counter any weakening of redistribution via the tax system.

However, it is less obvious that this “tax and growth” ranking can be exploited for short-term demand purposes in the current crisis. Lowering tax rates on corporate income is unlikely to have much impact on investment demand as corporate profits slump, and raising taxes on property would weaken already-depressed housing markets.

A third special chapter illustrates that most OECD countries have continued to make significant progress in reducing regulatory constraints on competition in product markets over the past five years. This welcome development bodes well for innovation and productivity in the longer term, and may prove helpful in dealing with the current crisis. Notwithstanding this progress, regulations still unduly constrain healthy competition in some sectors and some OECD countries, notably lower income countries, who maintain a restrictive regulatory stance throughout their product markets. Reforming regulations is a priority for several countries to enhance their productivity in the long run, with some beneficial effects on demand in the short run.

A final special chapter shows that a significant proportion of the cross-country difference in aggregate employment rates and average productivity levels, and thus GDP per capita, is accounted for by differences in population structure, in particular along the educational attainment dimension. It demonstrates that differences between national aggregates and averages can be misleading and re-emphasises the importance of education. However, the noted differences in population structure do not affect countries’ areas of relative strength and weaknesses that forms the basis for the selection of policy priorities in *Going for Growth*.

With its focus on reforms to support long-term growth, this report represents a fundamental component of the OECD’s strategic response to the financial and economic crisis. It concludes that the economic crisis facing OECD countries should not be allowed to slow down structural reforms, and opportunities for reforms should be exploited to strengthen economic dynamism and living standards. Under no circumstances should mistakes from previous crises be repeated. In particular, attempts to cut unemployment by reducing labour supply would prove as damaging as in the past and leave our societies poorer; keeping markets open and avoiding new protectionism is key to strengthen prosperity throughout the world.

Klaus Schmidt-Hebbel

Chief Economist

OECD