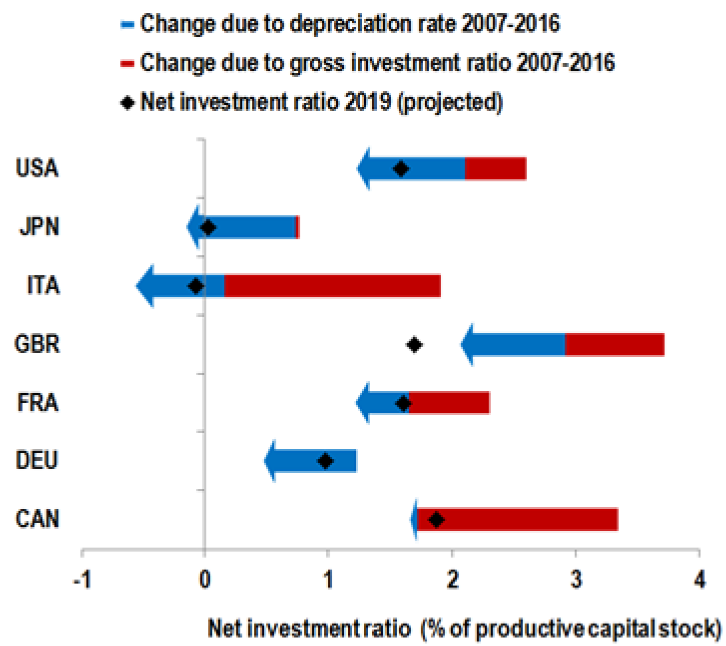
Investment, an engine of global growth that has yet to fire up

By Théodore Renault and Dorothée Rouzet, OECD Economics Department

Global growth has strengthened, but policymakers face the challenge of lifting their economies' long-term potential to ensure it remains robust and more inclusive. Private sector investment has slowed substantially in the past decade. Even though they have started to recover in most advanced economies, net investment rates remain well below pre-crisis levels and are projected to rise only modestly for the next two years (**Figure 1**) – see our latest Economic Outlook. The capital stock has been eroded by the double whammy of declining gross investment rates and faster depreciation – in part due to the shorter lifespan of technology investments. As a result, stronger investment than in the past is needed to maintain, grow or upgrade the capital stock, and to turn the opportunities offered by new technologies into sustained productivity growth.

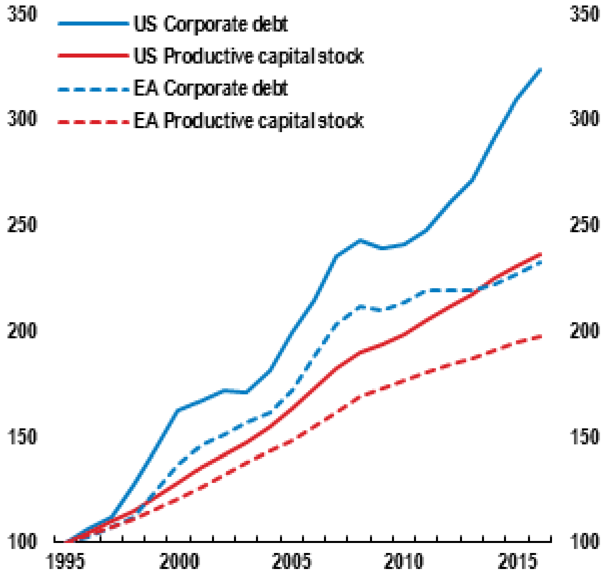
Figure 1 – Net investment ratios have fallen



Note: The net investment ratio is defined as the gross investment ratio minus the depreciation rate in % of the productive capital stock. It includes business plus government investment.
Source: OECD Economic Outlook database; and OECD calculations.

Investment rates have declined even as corporate debt has soared in the post-crisis period, as highlighted in the OECD Economic Outlook special chapter on "Resilience in a Time of High Debt". This raises questions about what the funds are used for. If borrowing is well used, rising corporate indebtedness can contribute to economic growth by raising productive capacity or improving productivity. This has by and large not been the case: corporate debt has for long risen faster than the productive capital stock in major economies, such as the United States or the euro area (**Figure 2**). A number of studies suggest that a substantial share of new debt has been used to return funds to shareholders through share buybacks and dividends, rather than financing investment (OECD, 2016). The gap between the cost of equity and debt may have also been a motivation to shift towards debt financing.

Figure 2 – Disconnect between debt and productive capital



Note: Based on nominal series. Excludes financial corporations.
Source: OECD National Accounts; OECD Economic Outlook database; and OECD calculations.

The divergence between investment and corporate debt raises concerns that too much debt may signal inefficient capital allocation. High levels of debt can hamper the ability of corporations to undertake new borrowing to finance productive investment. Over-indebted firms tend to lose dynamism, often even failing to keep up with the required investment to remain competitive, and thus can become “zombie” firms, not only impairing their own prospects but also holding back the performance of competing firms (Adalet McGowan et al., 2017).

Broad structural policy packages are needed to catalyse business investment towards stronger long-term growth prospects. Policy action to make product markets more competitive would raise the prospective rate of return on new investments and encourage innovation, leading to higher productivity growth and ultimately supporting wage and income growth. Reducing the tax bias towards debt and improving the design of insolvency regimes would help the financial system to be more resilient to shocks, thereby minimising the risks of sub-par growth in the medium term.

References

OECD (2017), *OECD Economic Outlook, Volume 2017 Issue 2*, OECD

Publishing, Paris.

OECD Economic Resilience website

Adalet McGowan, M., D. Andrews and V. Millot (2017), “Insolvency Regimes, Technology Diffusion and Productivity Growth: Evidence from Firms in OECD Countries”, *OECD Economics Department Working Papers*, No. 1425, OECD Publishing, Paris. http://dx.doi.org/10.1787/36600267-en

Caldera Sánchez, A., et al. (2017), “Strengthening Economic Resilience: Insights from the Post-1970 Record of Severe Recessions and Financial Crisis”, *OECD Economic Policy Papers*, No. 20, OECD Publishing, Paris. http://dx.doi.org/10.1787/6b748a4b-en

OECD (2016), *OECD Business and Finance Outlook 2016*, OECD Publishing, Paris.
http://dx.doi.org/10.1787/9789264257573-en