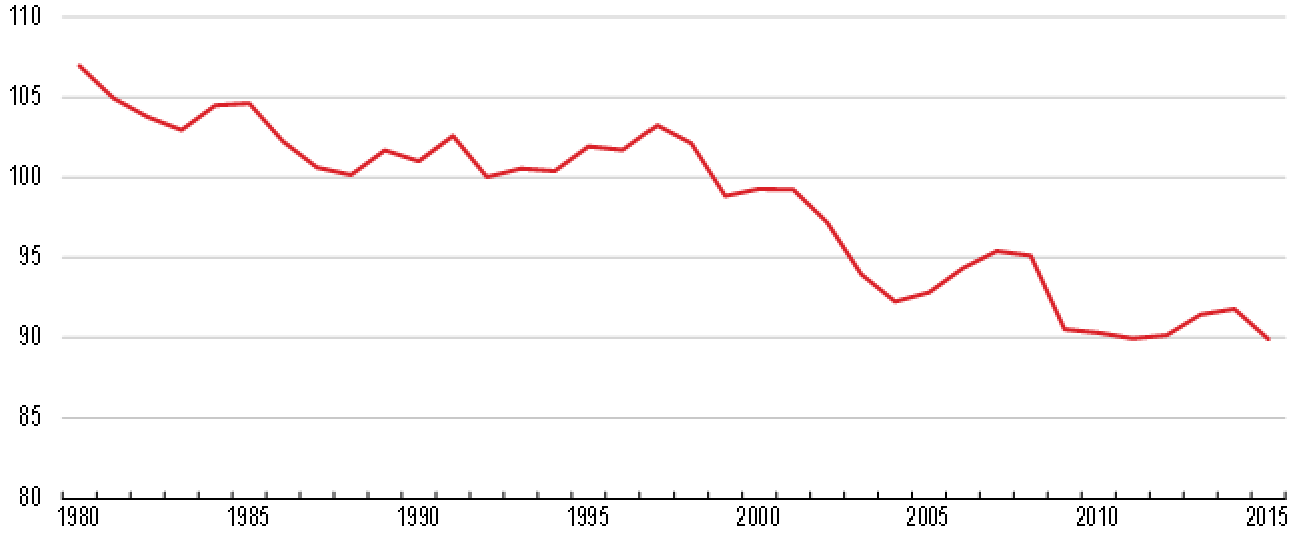
Switzerland's productivity puzzle: Being a leader and an underperformer

Category: Productivity,Switzerland,Uncategorized
written by oecdecoscope | January 8, 2018
by Patrice Ollivaud, Economist, Switzerland Desk, OECD Economics Department

Switzerland is among the leaders in many global rankings including on R&D, innovation, infrastructure, universities and competitiveness. It is well integrated in global value chains, specialised in some high-value-added activities and home of many large multinationals. These factors should contribute to high, and rising, labour productivity. However, it has been falling behind other OECD countries, including the United States (Figure 1). Switzerland's labour productivity still ranks amongst the top-10 OECD countries, but its growth performance has been poor in recent decades. During the 2000s its GDP per capita growth was driven mainly by an increasing employment rate, which reached record highs. That no longer has much scope to continue, which calls for focusing policy efforts on bolstering productivity to sustain Swiss living standards.

Figure 1. Hourly labour productivity compared to the United States
Constant prices, 2010 USD in PPPs, USA=100



Source: OECD, *Productivity database*.

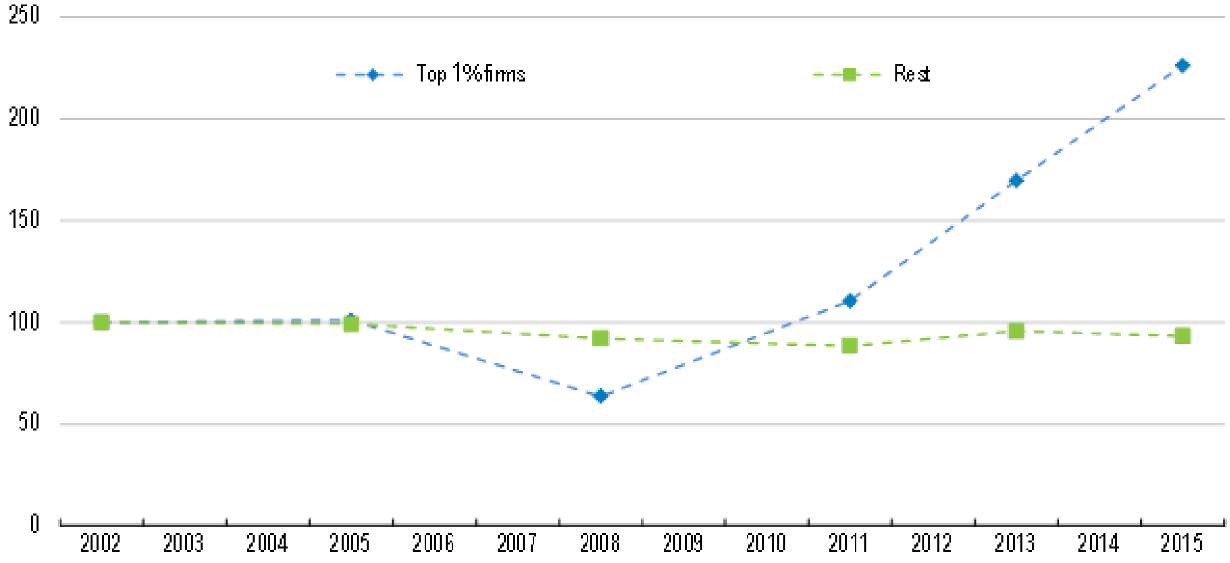
The recently published *OECD Economic Survey of Switzerland* (OECD, 2017) studies Swiss labour productivity from a firm-level perspective using the KOF Swiss Innovation Survey database. The results point to a growing gap between Swiss frontier firms and the rest (Figure 2), similar to the pattern observed in other OECD countries (Andrews et al., 2016). This is particularly the case in the services sector.

Labour productivity growth is higher in firms that have introduced innovations and those with a larger share of high-skilled employees. However, fewer and fewer firms conduct R&D, while they spend more and more francs on it. This accentuates the concentration of R&D in a limited number of firms (around two-third of patents over 2006-11 originated from just 20 firms) and in pharmaceuticals (which accounted for nearly 30% of Switzerland's business R&D in 2013). In addition, small firms report facing constraints in finding workers with needed skills.

This suggests the existence of a two-speed economy. A small segment of firms does extremely well. Others are suffering, driving the weak overall labour productivity growth outcome.

Figure 2. Firm performance has diverged since the crisis

Labour productivity, 2002=100



1. Markers denote survey years. Labour productivity is value added per employee; it is not adjusted for average hours worked per employee. The sample of the 1% most productive firms is recalculated each survey year at the 2-digit industry level. See Chapter 1 in OECD (2017) for further details of the calculation.

Source: OECD calculations based on KOF, *Swiss Innovation Survey database*.

Facilitating firm entry and exit are key ingredients for business dynamism and boosting productivity growth. Furthermore, entrepreneurship is not very high for the 18-24 year-old population. Several recommendations would boost the creation of innovative start-ups:

- Promoting incubators at higher education institutions
- Increasing the share of academic staff with entrepreneurial skills
- Facilitating collaboration between firms through universities and research laboratories.

Risk-taking would also be facilitated – pushing up start-up rates – if Switzerland implemented a personal bankruptcy regime, allowing honest, hard-working entrepreneurs to have a second chance.

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Statistical Insights: Merchandise trade statistics without asymmetries

Category: Statistical Insights,Uncategorized
written by oecdecoscope | January 8, 2018
by Fabienne Fortanier, Head of Trade Statistics Section, OECD Statistics Directorate

To properly understand global trade patterns we need high quality, consistent and harmonised statistics on international merchandise trade. Currently available statistics, however, fall short of this standard. In theory the exports of country A to country B should mirror the imports of country B from country A, but in practice this is rarely the case. To tackle this issue the OECD, through its Working Party on International Trade in Goods and Services Statistics, bringing together over 40 countries, has developed a transparent and replicable approach for reconciling international merchandise trade statistics. The first version of the resulting dataset is now available.

How large are trade asymmetries?

Table 1 shows some of the largest asymmetries in reported global trade, by main product category. And they are very large. For example, the US reports USD 35 billion more imports of electrical machinery from China than China reports as exports to the US; accounting for around one-third of the actual value traded. The twelve top discrepancies alone (out of nearly 100 products and over 200 countries), account for USD 182 billion, or 1% of global merchandise trade.

Table 1. Examples of large trade asymmetries (reported imports and mirror exports), by product 2014, million USD

Reporter country	Partner country	Product (HS chapter number)	Reported imports	Mirror exports	Imports -/- Exports
Netherlands	Russia	Mineral fuels and oils (27)	21 650	57 294	-35 644
USA	China	Electrical machinery, equipment and parts (85)	127 093	92 550	34 543
China	Korea	Electrical machinery, equipment and parts (85)	76 674	51 182	25 492
China	Japan	Electrical machinery, equipment and parts (85)	40 572	25 751	14 820
USA	China	Nuclear reactors, machinery & mechanical app. (84)	105 279	90 883	14 396
Germany	China	Electrical machinery, equipment and parts (85)	28 804	14 458	14 346
Germany	Norway	Mineral fuels and oils (27)	8 137	20 105	-11 968
France	China	Electrical machinery, equipment and parts (85)	14 397	5 551	8 846
France	Russia	Mineral fuels and oils (27)	11 641	4 132	7 509
Netherlands	China	Nuclear reactors, machinery & mechanical app. (84)	15 695	22 019	-6 323
Spain	France	Vehicles and parts (87)	10 664	5 105	5 559
Spain	Russia	Mineral fuels and oils (27)	6 971	3 421	3 550

Source: UN Comtrade

Why do trade asymmetries exist?

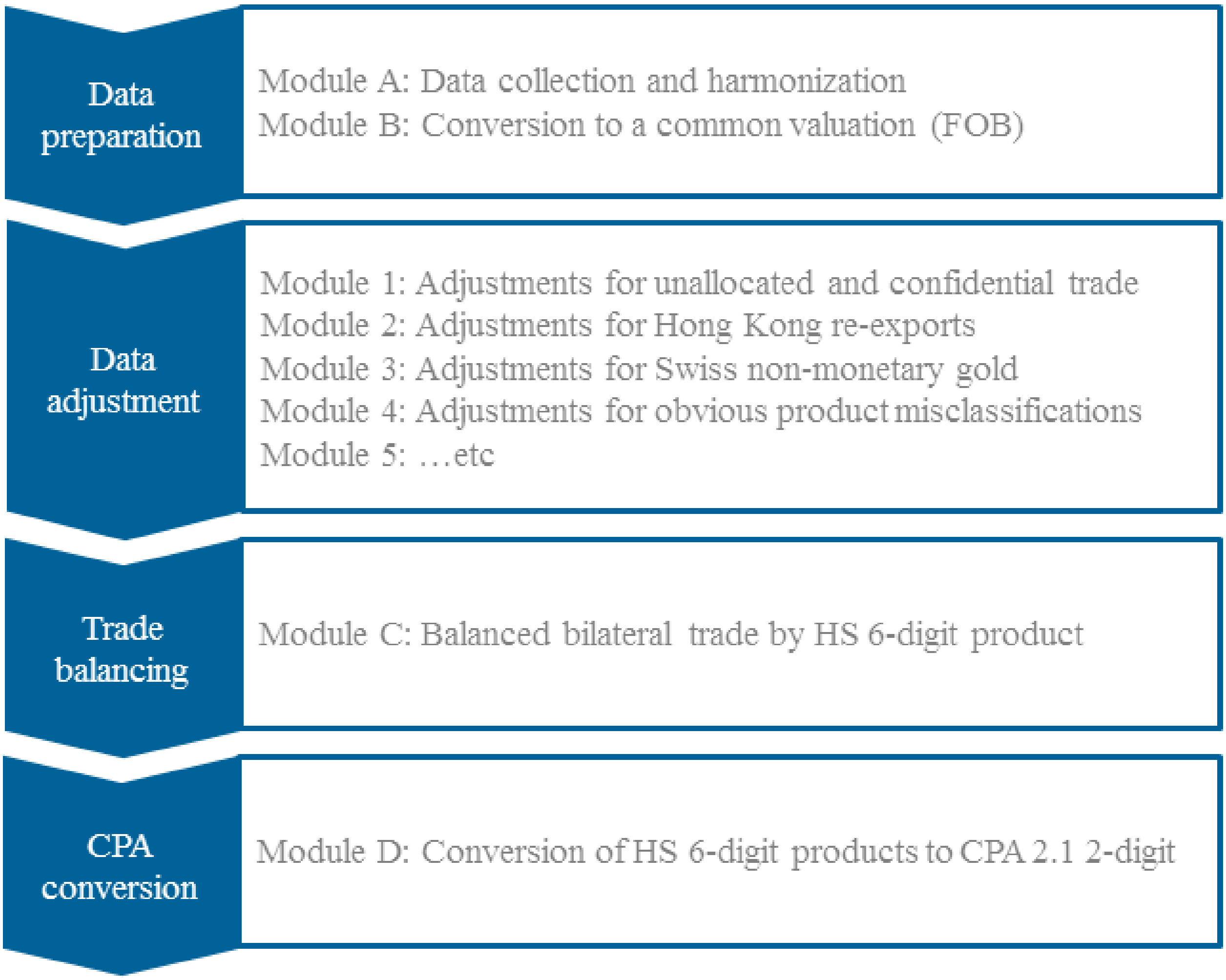
Asymmetries in international merchandise trade statistics exist for a variety of reasons. First of all, exports and imports are valued differently: exports are valued ‘free on board’ (FOB), but imports include the ‘costs of insurance and freight’ (CIF). This margin however averages just 5% of international trade flows (Miao and Fortanier, 2017) and so explains only a small part of the discrepancies. Differences in customs regimes and methodologies also have an effect, as do differences in confidentiality policies, product classifications, and time of recording.

But the most important source of discrepancy is the convention that merchandise trade statistics record imports by country of origin and exports by country of last known destination. This inevitably means that import data will not mirror export data – and the gaps are steadily widening as global production chains become more complex.

Resolving asymmetries – the measure explained

The OECD has developed a four-step process to reconcile merchandise trade asymmetries (Figure 1). First, data are collected and organised, and imports are converted to FOB prices to match the valuation of exports. Secondly, data are adjusted for several specific large problems known to drive asymmetries. Presently these include 'modular' adjustments for unallocated and confidential trade, for re-exports by Hong Kong, China, for Swiss non-monetary gold, and for clear-cut cases of product misclassifications. The list of modules is expected to grow over time. In the third step, adjusted data are balanced using a 'Symmetry Index' that weights exports and imports, giving a higher weight to the country with less asymmetry in its reported bilateral trade flows. This Index reflects the share of a reporter's bilateral trade for which the absolute difference with the reported mirror flow is 10% or less of the sum of these two flow values. All calculations are made at the detailed product level (HS 6-digit), and the dataset is available at this level. However, in a final step, the data are also converted to Classification of Products by Activity (CPA) products to better align with National Accounts statistics, such as in national Supply-Use tables.

Figure 1. Schematic overview of the steps involved in creating the balanced merchandise trade dataset



As a concrete example of how adjustments are made, take re-exports by Hong Kong, China (hereafter Hong Kong). Hong Kong is a major hub for international merchandise trade, and re-exports account for no less than 96% of its total exports. This leads to large asymmetries, because, following international methodological standards, Hong Kong reports exports to those countries where the products are sent, but the same countries report them as imports not from Hong Kong, but from the country in which they were originally produced.

These asymmetries can be reduced by using the Hong Kong Census Office’s detailed 6-digit data on the country of origin of its re-exports. Table 2 illustrates this in the case of data for 2011 on trade in Harmonised System product category 851762 (“Machines for the reception, conversion &

transmission/regeneration of voice, images and other data”). The first data column shows the reported figures by each respective country, and the second column, the adjusted figures. The first column shows that China recorded nearly USD 5 billion of exports to the US, with Hong Kong exporting a further USD 2.1 billion, virtually all of which (USD 1.9 billion) were re-exports from China. In contrast, and consistent with the country of origin principle, the US recorded virtually all of its imports of these goods as coming from China (nearly 9 billion USD), with negligible amounts from Hong Kong. The second column reattributes US imports passing through Hong Kong as imports from Hong Kong, reducing imports attributed to China by the same amount. Note that this does not change China or Hong Kong’s reported exports, or the total value of the US’s reported imports. But changing the geographical attribution of US imports reduces the asymmetry between China and the US by almost half, and practically eliminates the asymmetry between Hong Kong and the US.

Applying this method reduces asymmetries between Hong Kong exports and partner country imports by 60% overall, and to practically zero for many partner countries. Asymmetries between country pairs like the US and China that trade significantly via Hong Kong are also reduced by 5-10%.

Importantly, by tracking the physical flow of goods, the approach adopted in the database provides a means to better highlight the port and transportation services, related to ‘entrepôt’ transactions, in trade in value added statistics.

Table 2. Example of trade asymmetries between China and the US where re-exports from Hong Kong are important, before and after re-export adjustment (thousand USD, 2011)

	HS 851762*	HS 851762* adjusted
(1) Exports of China to the US	4 975 623	4 975 623
(2) Exports of Hong Kong to the US	2 097 909	2 097 909
(3) of which re-exports originating from China	1 920 029	1 920 029
(4) Imports of the US from China	9 482 884	7 562 855
(5) Imports of the US from HK	138 023	2 058 052
China-US asymmetry (abs)	4 507 261	2 587 232
Hong Kong-US asymmetry (abs)	1 959 886	39 857

*HS 851762: Machines for the reception, conversion & transmission/regeneration of voice, images and other data

Where to find the underlying data

The database currently contains data for 83 countries for all 2-digit CPA products for the period 2007 to 2014. More countries and years (from 2002 to 2016) will be added in Q1 2018 and updates will be conducted on an annual basis from hereon in. The plan over the next two years will be to accelerate the production process such that the most timely data are available with a lag of no more than one year to the reference period. Further work to reduce asymmetries in official data, including through bilateral and multilateral meetings, is under way in collaboration with national statistical offices and other international organisations.

- Access the database

Further reading

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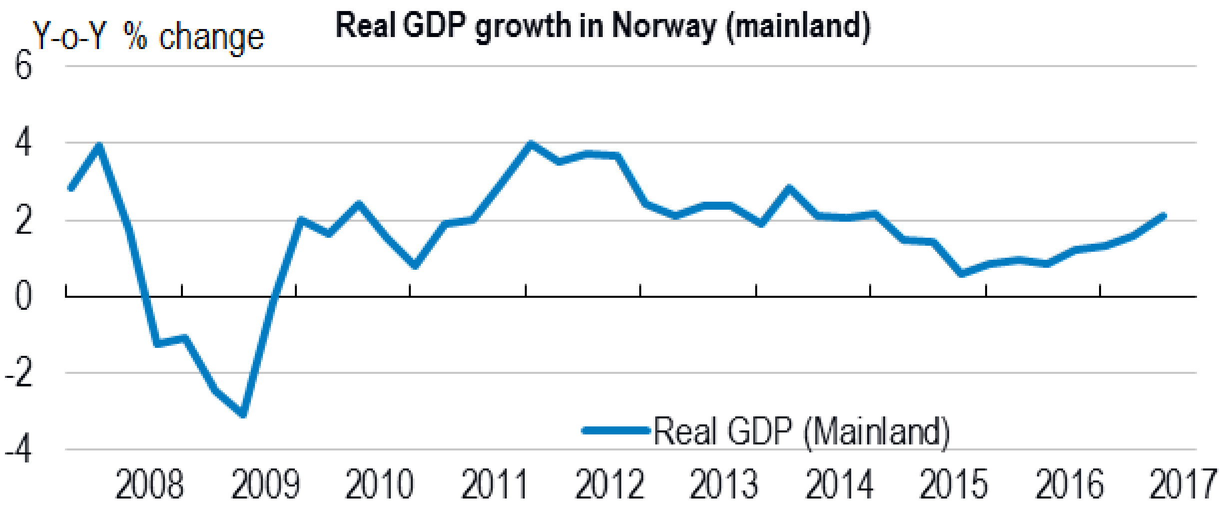
- Fortanier, F (2016), ‘Towards merchandise trade statistics without asymmetries’, *The OECD Statistics Newsletter*, issue 64.

Norway’s economy, a need to ensure policies can cope with upcoming challenges

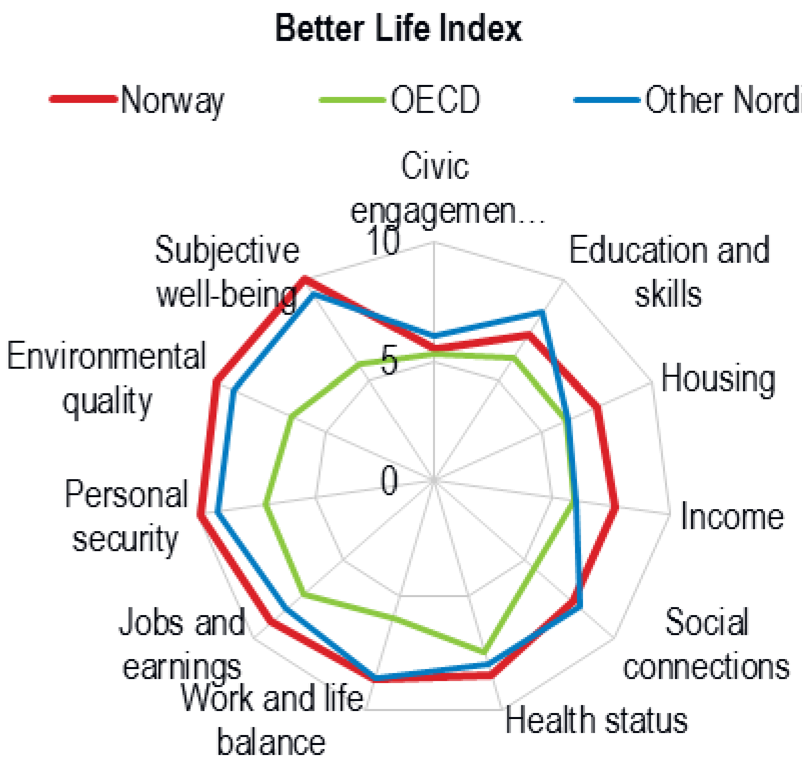
Category: Norway,Uncategorized
written by oecdecoscope | January 8, 2018
By Philip Hemmings, OECD Economics Department

In its latest *Economic Survey* for Norway , the OECD underscores the importance of policy facilitating transition away from oil-related activities and helping businesses seize opportunities from digitalisation and globalisation, through providing *i)* macroeconomic and financial stability, and *ii)* improvements to structural-policy settings. It also recommends making public expenditure services more efficient, so as to reduce the injection of oil-money into the economy and to ensure an equitable participation in oil-wealth returns across future generations. An in-depth look at public spending on transport infrastructure is also discussed.

The Norwegian economy continues to perform well, despite low oil prices. Output growth is recovering, wellbeing remains high in many dimensions, and Norway stands as one of the OECD’s most inclusive countries in terms of income equality, labour participation and gender gaps.



Source: OECD Economic Outlook 102 database.



For Norway's society to remain inclusive as its petroleum resources decline and its population ages, the business sector will have to diversify to non-oil sectors and continue to exploit opportunities from globalisation and technological change. The policy environment is business-friendly in general, with sound framework conditions and macroeconomic management. In particular, the floating exchange rate has proved a critical mechanism in adjustment to shocks. Also, the protection from 'Dutch disease' provided by Norway's main wealth fund supports diversification of the economy. However, policy cannot afford to stand still. The house-price correction that is currently underway in a context of high household debt potentially poses near-term policy challenges.

Also, Norway, similar to many other economies, has experienced a step-down in productivity growth. In addition, unit labour costs remain comparatively high. Policy needs to help business seize opportunities from globalisation and facilitate diversification away from oil-related activities; this is the theme of Chapter 1 of the OECD's latest *Survey*. The dynamism of Norwegian businesses would be helped if the public sector became more efficient. This would create room for lowering taxes, including those taxes that most strongly influence businesses costs and returns. The large role of publicly-financed services and investments in the economy means that returns to efficiency gains are substantial. However, oil-and-gas wealth has traditionally diminished motivation for seeking such gains. Chapter 2 of the OECD's *Survey* focuses on transport infrastructure investment. Such investment can widen economic opportunities for business and increase welfare for households. Realising these returns requires that transport-infrastructure investment is well chosen and implemented efficiently.

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High household debt: a challenge for medium-term growth?

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written by oecdecoscope | January 8, 2018
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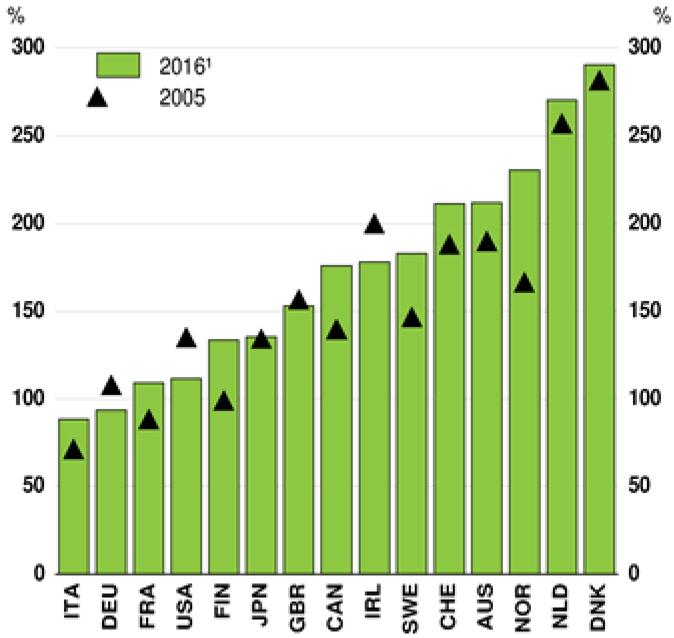
The global economy is now growing in sync at his fastest pace in years, but financial vulnerabilities create challenges for medium-term growth. Private indebtedness, including of households, remains a source of concern, as set out in the special chapter of our latest Economic Outlook on "Resilience in a time of high debt". Household debt ratios in many advanced economies as well as some emerging markets have trended up from the late 1990s, mostly peaking up around the onset of the financial crisis and stabilising at historically high levels thereafter. Household debt dynamics over the past decade nevertheless exhibit significant cross-country variation. Indebtedness has continued to rise from high levels in the Scandinavian countries, Australia and Canada, whereas some deleveraging has occurred in a few countries (**Figure 1**). In EMEs, household debt remains below the levels experienced by advanced economies, but it has been buoyant over the last years particularly in some Asian economies.

Figure 1 – Household debt is high is many countries

% of disposable income

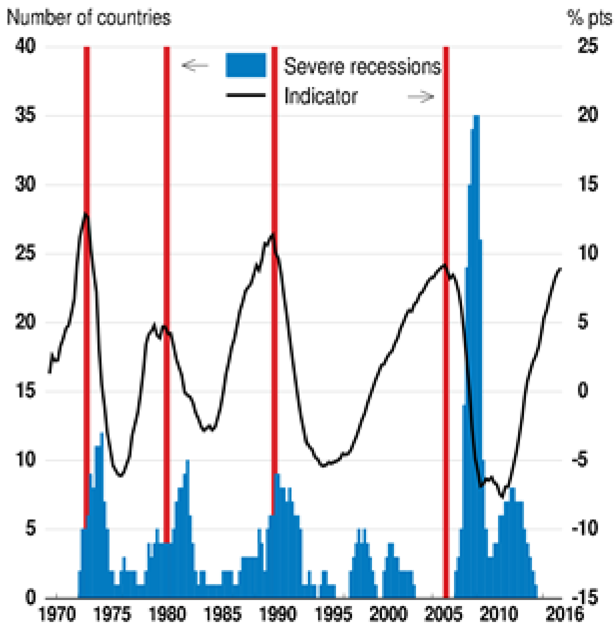


¹ or latest available.

Source: OECD National Accounts.

High and rising indebtedness creates vulnerabilities and exposes households to shocks via a number of channels. First, household debt ratios are closely linked to house prices and the credit cycle in mortgages can have strong effects on the price of dwellings. Among OECD countries, those that experienced the strongest increase in household debt since the crisis have also seen the steepest rise in house prices (André, 2016). Housing booms often lead to busts which cause severe economic downturns, as during recent global financial crisis. OECD research suggests that global risk indicators such as the global credit-to-GDP or global house prices appear to be predictive signals of future recessions (**Figure 2;** Hermansen and Röhn, 2017). Moreover, high household debt, alongside slow growth of disposable incomes, also implies that debt service costs may weigh on medium-term consumption growth, particularly for lower-income households.

Figure 2 – Real estate booms often precede severe recessions



Note: Blue areas represent the number of countries in a severe recession. The global real house price index is constructed as a GDP-weighted average across OECD countries and is measured as deviation from trend.

Source: Hermansen and Röhn (2017).

Reducing financial vulnerabilities and enhancing the resilience of households and financial systems in times of high private debt requires an integrated approach. An appropriate use of macro-prudential measures such as loan-to-value (LTV) or debt-to-income (DTI) is needed to prevent unsustainable credit fuelling housing dynamics. Easing strict regulations or controls that affect housing supply, including land-use regulations at the local level, could also help reduce vulnerabilities arising from high household debt.

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Zombie firms and weak productivity: what role for policy?

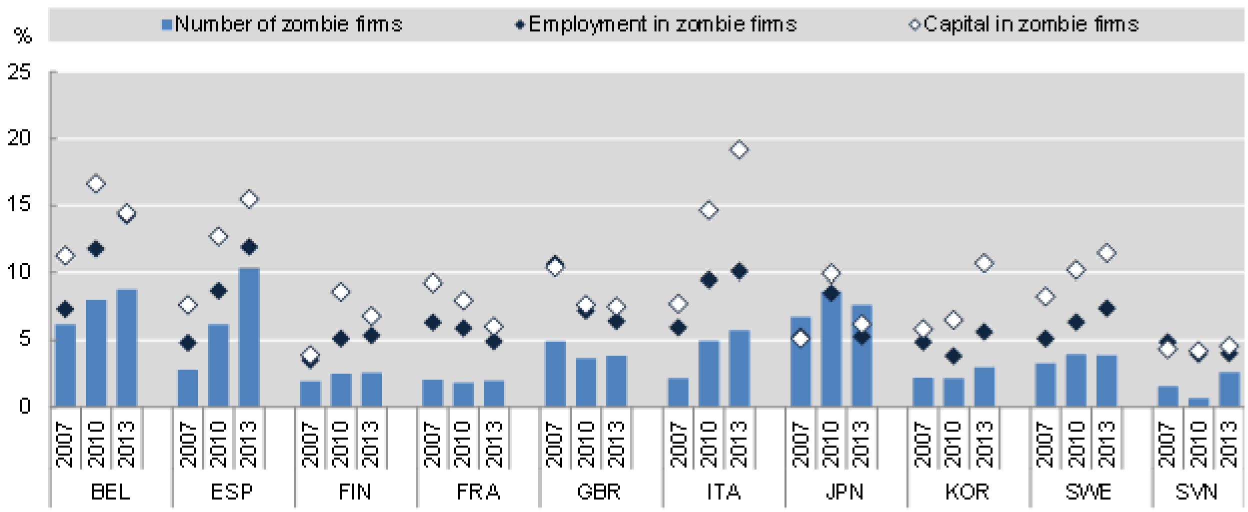
Category: Productivity,Uncategorized
written by oecdecoscope | January 8, 2018
by Dan Andrews, Müge Adalet McGowan and Valentine Millot, Productivity Workstream, OECD Economics Department

Weak productivity growth is a major problem afflicting our societies. It curbs growth in incomes and endangers the sustainability of our social security systems. An important, but often ignored, source of the productivity slowdown is the increasing prevalence of weakly productive firms and, among them, "zombie firms" – i.e. firms that would typically exit or be forced to restructure in a competitive market. In this context, a new OECD study shows that this prevalence is closely related to weaknesses in the banking system and insolvency regimes. It argues that reviving productivity growth will partly depend on the policies that restore banking health and effectively facilitate the exit or restructuring of weak firms, while simultaneously coping with any social costs that arise from a heightened churning of firms and jobs.

The problem

The prevalence and productive resources sunk in “zombie” firms – defined as old firms that have persistent problems meeting their interest payments – have risen since the mid-2000s in a number of OECD countries (Figure 1). In Italy, for example, the share of the industry capital stock sunk in zombie firms rose from 7% to 19% between 2007 and 2013. Zombie firms represent a drag on productivity growth as they congest markets and divert credit, investment and skills from flowing to more productive and successful firms and contribute to slowing down the diffusion of best practices and new technologies across our economies.

The rise of zombie congestion



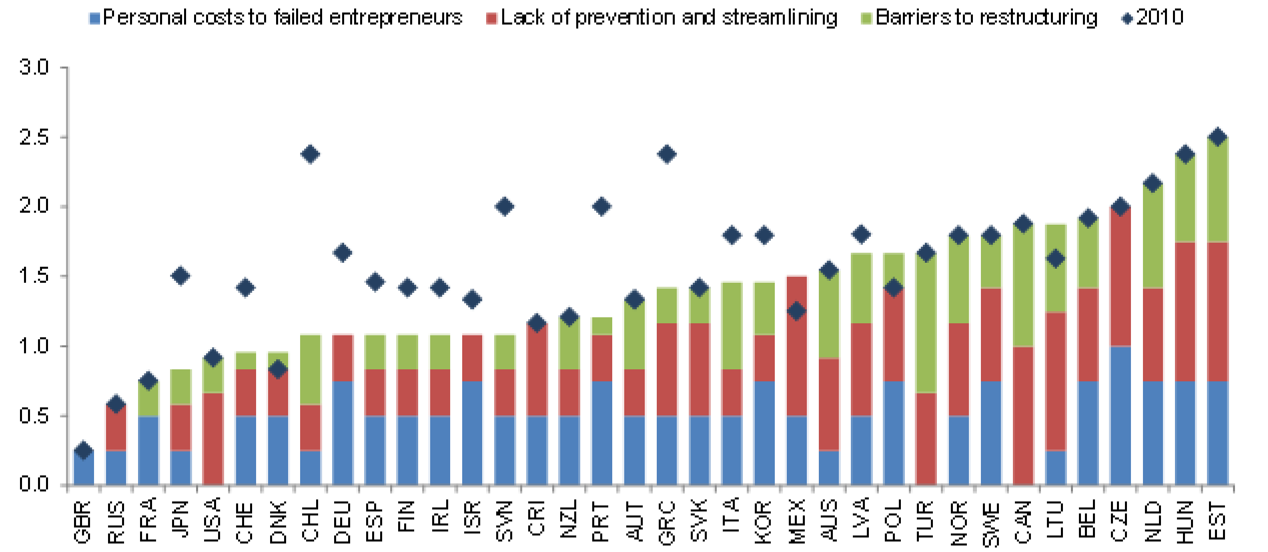
Note: Firms aged ≥ 10 years and with an interest coverage ratio<1 over three consecutive years. Capital stock and employment refer to the share of capital and labour sunk in zombie firms. The sample excludes firms that are larger than 100 times the 99th percentile of the size distribution in terms of capital stock or number of employees.
Source: Adalet McGowan, Andrews and Millot (2017).

Data from figure available here.

What can policy do?

New OECD indicators suggest that there is much scope to improve the design of insolvency regimes to accelerate the restructuring or exit of weak firms and thus revive productivity growth (Figure 2). For example, insolvency reforms that reduce barriers to corporate restructuring and the personal cost associated with entrepreneurial failure could translate into a decline in the zombie capital share of at least 9 percentage points in Spain, Italy or Portugal – countries where the zombie capital share stood at 28%, 19% and 16% in 2013, respectively. The good news is that in recent years insolvency reforms have already taken place in a number of countries, which are likely to partly achieve some of these gains.

Barriers to exit or restructuring imposed by insolvency, 2010 and 2016



Note: The stacked bars correspond to three subcomponents of the insolvency indicator in 2016. The diamond corresponds to the value of the aggregate insolvency indicator based on these three subcomponents in 2010.
Source: Adalet McGowan, Andrews and Millot (2017).

Data from figure available here.

Zombie firms are more likely to be connected to weak banks, suggesting that zombie congestion partly stems from bank forbearance – i.e. the tendency for weak banks to bet on the resurrection of failing firms. This underscores the importance of a more aggressive policy to resolve non-performing loans, but this can only be truly effective if accompanied by complementary reforms to insolvency regimes. Distortions in the banking sector also highlight the importance of market-based financing instruments for productivity growth, with the inherent debt bias in corporate tax systems and the lack of venture capital financing emerging as key barriers to technological diffusion.

Finally, reforms that accelerate corporate restructuring should be coupled with policies to manage the social costs of worker displacement. Job search and retraining programs turn out to be effective in returning workers displaced by firm exit to work, particularly in environments where barriers to firm entry are low as this stimulates job creation.

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Getting the most out of Fintech in Estonia

Category: Estonia,finance,Uncategorized
written by oecdecoscope | January 8, 2018
By Caroline Klein, Estonia Desk, OECD Economics Department and Olena Havrylchyk, Professor of Economics at the University of Paris 1 Panthéon Sorbonne

Pioneers of the Estonian Fintech need a fair level playing field. Estonia, at the forefront of alternative finance should seize the moment to set framework conditions right.

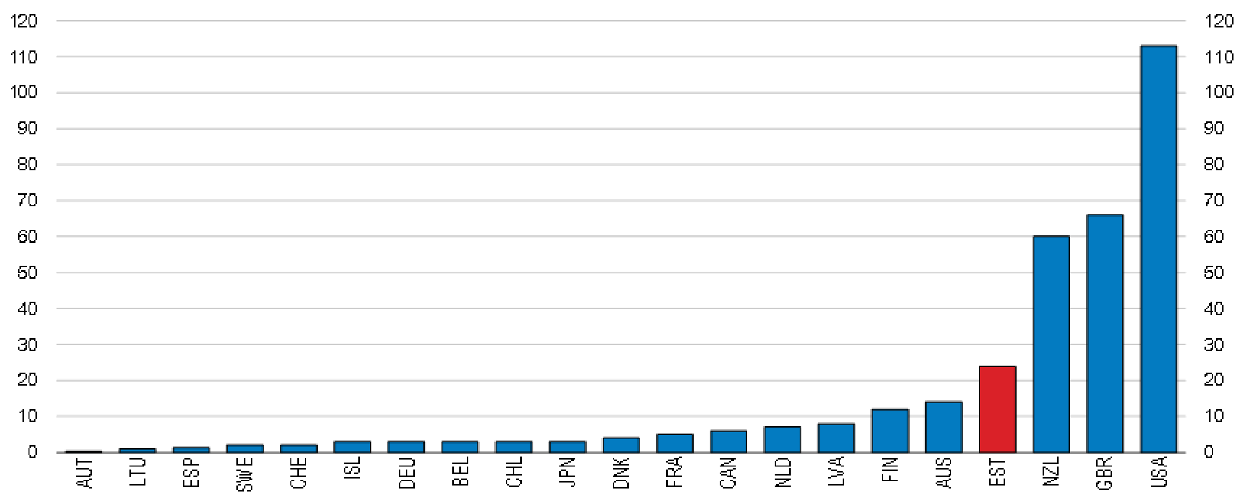
Estonia is a frontrunner in alternative finance and a host to some of the most innovative Fintech start-ups in the OECD – i.e. start-ups using technology and technology-facilitated new business models in the provision of financial services. Some Fintech companies based or born in Estonia have a world-wide reach. These include one of the largest European peer-to-peer lending platforms for unsecured consumer loans, the first worldwide secondary market for venture capital and a platform that allows individuals and small businesses to transfer money between international accounts at much lower cost than traditional banks.

For some, Fintech will revolutionize the traditional banking industry as we know it today, but for the moment, the platforms finance mostly risky projects. At one end of the platform, there are retail investors who choose whom they would like to finance. On the other end, there are SMEs and start-ups that do not go to banks, often because they cannot provide standard guarantees. The platforms generate profits from the origination and servicing fees that they charge to funders and fundraisers. The investors bear all investment risks, providing a natural ‘bail-in’ mechanism. Equity crowdfunding platforms can complement angel- and venture-capital, by allowing individuals to invest in start-ups and buy shares which are not listed on the regulated stock market.

For the moment the scale of finance channelled through Fintech platforms remains limited (Figure 1) and peer-to-peer lending to SMEs lags far behind consumer lending. The *2017 Economic Survey of Estonia* stresses that a sustainable development of this ‘alternative finance’ requires a creation of a level playing field between the traditional and the alternative sources of credit in terms of access to information, regulation, and taxation.

Figure 1. Estonia is a frontrunner in alternative finance but amounts are low

Volumes, in euros per capita, 2015



Note: Alternative finance includes peer-to-peer lending, equity crowdfunding, donation and reward crowdfunding, as well as balance sheet lending.

Source: Cambridge Centre for Alternative Finance.

To build confidence in these new financing forms, a necessary condition to their development, consumer protection of Fintech users should be reinforced. The Estonian authorities should introduce licencing and transparency requirements and require the platforms to have resolution plans in place to ensure that repayments continue to be collected in case of bankruptcy. By establishing a well-designed credit information-sharing scheme covering all borrowers (firms and individuals) it could help to move the industry forward, by facilitating the use of big data and algorithms to screen and monitor borrowers. Finally, the level playing field should be established also when it comes to taxes. Taxation of investment via Fintech platforms should be harmonised with that of bond and equity securities, by allowing investors to deduct their losses from their income tax base.

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Brighter futures or dashed expectations? The global recovery needs to deliver gains for all

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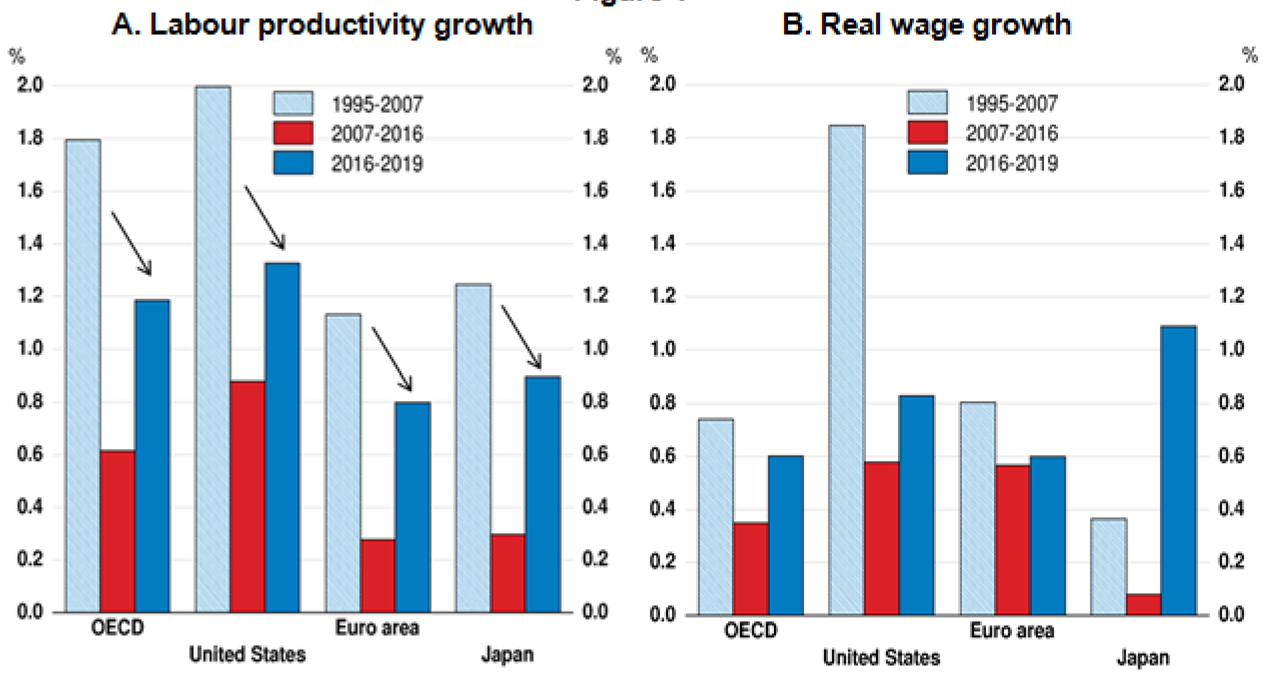
written by oecdecoscope | January 8, 2018
By Lukas Lehner and Dorothée Rouzet, OECD Economics Department

Global growth has gained momentum in 2017 and the economic recovery is moving forward, as shown in our latest Economic Outlook. Labour productivity is improving from its decade-long sluggishness. Yet, expected productivity gains still lag far behind pre-crisis norms, and will not be sufficient to set the stage for long-term improvements in living standards (Figure 1, Panel A). Multiple structural obstacles – including a lack of competition and business dynamism and high shares of “zombie” capital – slow down the investment, innovation, and technology diffusion that are crucial for productivity growth.

Figure 1



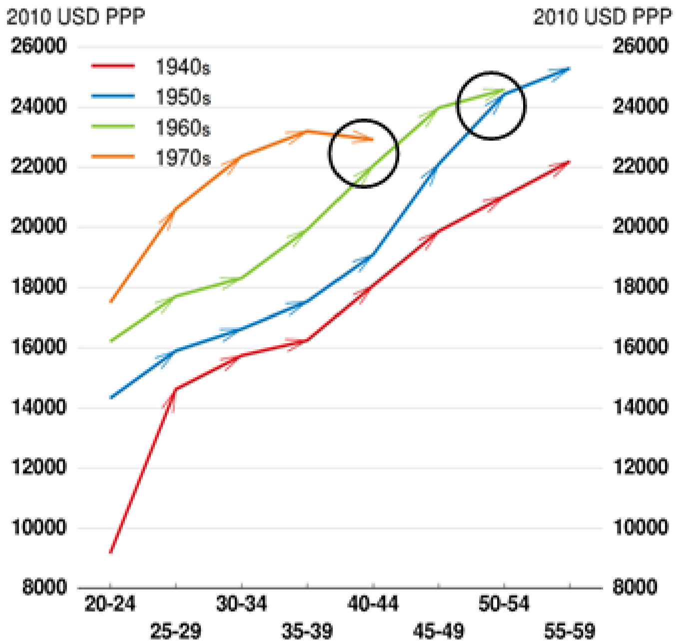
Note: Labour productivity growth is the average annual growth rate of output per person employed. Real wage growth is calculated from nominal wage growth and the GDP deflator. 2017-2019 are projections.
Source: OECD Economic Outlook database.

Slow labour productivity growth has been a driver of slow increases in real wages, alongside remaining hidden labour market slack, a rise in non-standard forms of employment and weakened labour market institutions (Figure 1, Panel B). This means that in most advanced economies, incomes are unlikely to rise in line with the pace that households experienced in pre-crisis decades, and that they have come to expect for the future.

Without stronger and more widely shared productivity, wage and income growth, promises to younger generations will not be kept. In the past, each generation used to enjoy rising incomes over their working lives and higher living standards than their elders. These trends have slowed or even reversed in the last decade for generations currently in their prime working age (Figure 2). Real incomes have decreased for people born in the 1970s, feeding into public dissatisfaction. Ensuring that this lost decade does not become a "lost generation" is a call for deeper policy changes.

Figure 2: Income gains across generations have slowed

Real disposable income by age and birth decade, OECD



Note. Data cover 24 OECD countries. The series shown are derived for each cohort from a specification controlling for country and age fixed effects.
Source: Preventing Ageing Unequally, based on data from the Luxembourg Income Study.

To raise prospects for better living standards for their populations, policymakers need to take action to catalyse more robust investment and productivity gains towards higher wages and incomes for all. Reform packages should focus on promoting competition and trade, improving active labour market policies and social protection, and developing human capital to seize the opportunities of the future. The short-term momentum provides a window for bold action that could and should promote stronger and more inclusive growth.

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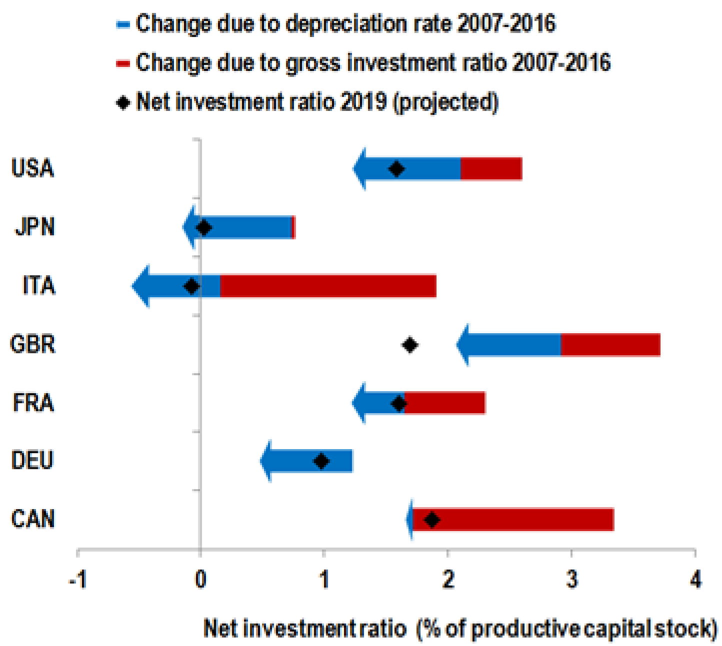
Investment, an engine of global growth that has yet to fire up

Category: Economic outlook,investment,Uncategorized
written by oecdecoscope | January 8, 2018
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.

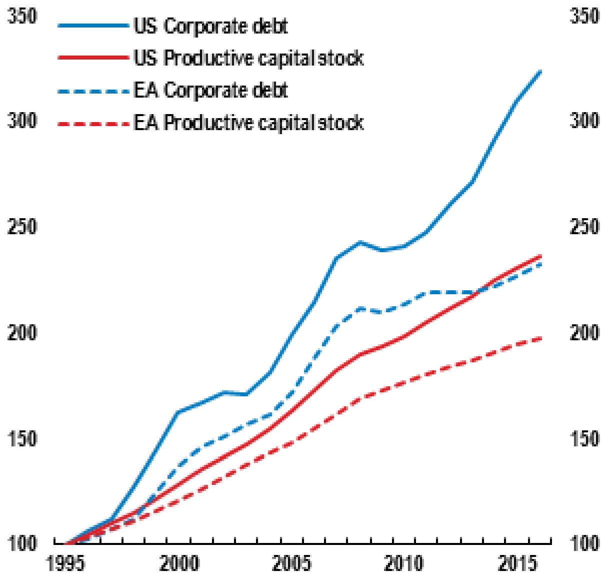
Figure 1 – Net investment ratios have fallen



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.

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The Policy Challenge: Catalyse the private sector for stronger and more inclusive growth

Category: Economic outlook,Uncategorized
written by oecdecoscope | January 8, 2018
by By Catherine L. Mann, OECD Chief Economist and Head of the Economics Department,

Global economic growth is strengthening, with incoming data surprising on the upside. We project global GDP growth to be between 3 ½ and 3 ¾ per cent through the projection horizon, closer to long-run averages. Will this synchronised momentum finally propel the global economy to gather enough speed to raise productivity, real wages, and living standards for all?

OECD Economic Outlook projections

Real GDP growth

Year-on-year, %

Arrows indicate the change in growth rate from previous year

	2016	2017 November projections	2018 November projections	2019 November projections
World	3.1	3.6 ↑	3.7 ↑	3.6 ↓
United States	1.5	2.2 ↑	2.5 ↑	2.1 ↓
Euro area[1]	1.8	2.4 ↑	2.1 ↓	1.9 ↓
Germany	1.9	2.5 ↑	2.3 ↓	1.9 ↓
France	1.1	1.8 ↑	1.8 →	1.7 ↓
Italy	1.1	1.6 ↑	1.5 ↓	1.3 ↓
Japan	1.0	1.5 ↑	1.2 ↓	1.0 ↓
Canada	1.5	3.0 ↑	2.1 ↓	1.9 ↓
United Kingdom	1.8	1.5 ↓	1.2 ↓	1.1 ↓
China	6.7	6.8 ↑	6.6 ↓	6.4 ↓
India[2]	7.1	6.7 ↓	7.0 ↑	7.4 ↑
Brazil	-3.6	0.7 ↑	1.9 ↑	2.3 ↑
Russia	-0.2	1.9 ↑	1.9 →	1.5 ↓

More robust and higher quality private sector investment, including in intangibles and skills, is key for long-term productivity and real wage growth. There are positive signs: surveys indicate that businesses intend to invest, particularly in technology-embodied capital; and the now synchronous global upturn signals demand for investment, particularly given the erosion of the capital stock. But, projected investment rates remain too low to sustain the acceleration of activity. As a result, our projection for global GDP for 2019 shows a tempering of growth rather than continued strengthening.

A myriad of obstacles (different across countries) stand in the way of the more robust investment crucial for productivity growth to meet the public’s expectations for higher living standards, and to fulfil the longer-term commitments of governments to provide solid career paths for the young and adequate pensions for the old. For example, services restrictions create hurdles to invest, particularly for smaller firms; judicial delays hinder the clean-up of balance sheets and capture resources in poorly performing firms; housing policies can make it difficult to hire workers with the right skills, undermining investment by both workers and firms.

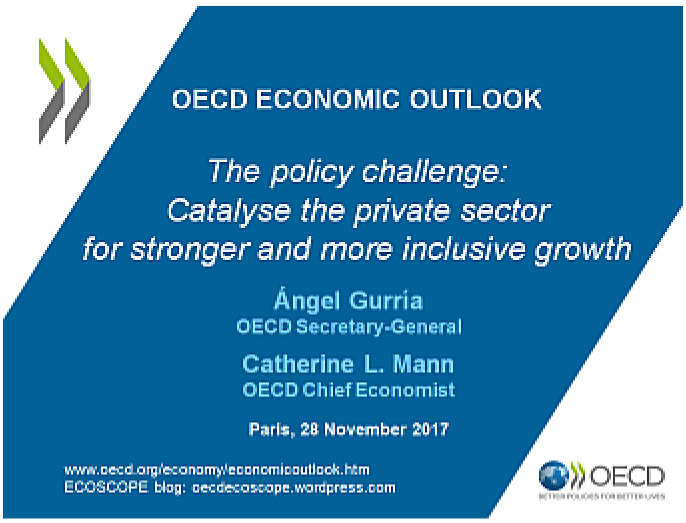
Some people think that the per capita income growth enjoyed in previous decades is out of reach, and that those expectations are unrealistic or even inappropriate, given demographic and environmental considerations. On the former, OECD research shows that changes in pension policies to promote longer working careers and increased participation of women can offset much of the demographic drag on potential output. On the latter, the OECD report “Investing in Climate, Investing in Growth” shows a path to better well-being consistent with climate change commitments. More robust productivity growth is needed to raise wage prospects in advanced economies and higher investment—in social, public, human, and physical capital (with different combinations for different countries)—is needed for emerging economies to sustain catch-up in living standards.

Financial markets provide additional signals that real investment has yet to fully fire, and that incentives are misaligned. When firms invest in financial assets rather than in real capital, asset prices rise relative to long-term growth prospects. Evidence continues to build that financial asset prices are inconsistent with expectations for future growth and the policy stance, exacerbating the risks of financial corrections and growth downdrafts. Vulnerabilities appear through a number of channels: volatility measures are low even as the probability of sharp corrections is high, equity prices are high relative to expected growth rates and discount rates, credit spreads are narrow relative to risks, bond yields are low relative to probable outcomes of fiscal and monetary policies, and historically-high duration exposes bond holders to interest rate normalisation. Current global growth rates, and fiscal and monetary space are too limited to weather a financial downdraft. This puts an even greater premium on structural policy efforts.

Policymakers need to trigger deeper changes to their policies to catalyse investment, productivity, and real wage growth and make growth more inclusive. The OECD's *Going for Growth* exercise documents that many countries have focussed and made progress on policies that enhance labour market fluidity and participation by redesigning benefits and "making work pay", and by improving childcare so as to enhance labour force inclusion of women. These reforms have paid off with higher employment rates, particularly among groups that typically have been more weakly attached to the labour market. However, for these reforms to be reflected in high productivity and real wage growth, opportunities for right-skilling need to improve and productivity gains need to diffuse from the frontier to all firms. Further, competition in markets enhances competition for workers, making for better skill matching and higher real wages. Policymakers' efforts on product market reforms have been less ambitious, in particular on anti-trust/competition policy action and on trade and investment policies; indeed, threats to roll back openness permeate the policy landscape. Although progress has been made on financial market repair, zombie firms still capture too much labour and capital, taking a toll on business dynamism, productivity and real wage growth.

The financial crisis prompted structural reform and new regulation of parts of the financial system, but private sector debt remains high. The past decade has seen a growing reliance by firms on bond financing at attractive rates, with deteriorating credit quality and use of international issuance, as set out in Chapter 2 of this *Economic Outlook* on "Resilience in a Time of High Debt". While credit is needed to support economic activity and innovation, it can increase risks, lower growth and raise inequality. An integrated policy approach is needed to enhance the financial resilience of economies to shocks and to minimise the risks of sub-par growth in the medium term. Financial regulation should not focus only on risk, but also on growth.

Policy fatigue and sluggish growth in the past decade have curbed reform ambitions. And some might suggest that the global upturn means that no more policy effort is needed. In fact, the rapid pace of technological change – digitalisation, robotics, artificial intelligence, cloud computing – demands deeper and more extensive reforms, not complacency. Attention to the local challenges of global and technological changes has to ensure that opportunities will be shared. Those countries that step up policy efforts will create a better environment for their firms and public. With the global upturn putting wind under the wings of policy, now is the time to redouble the effort.



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Should we worry about high household and corporate debt?

Category: Economic outlook,Uncategorized
written by oecdecoscope | January 8, 2018
By Catherine L. Mann, OECD Chief Economist and Head of the Economics Department, and Filippo Gori, Economist, Macroeconomic Policy Division, OECD Economics Department

Household and corporate debt in many advanced and emerging market economies is high in the wake of the financial crisis and following a decade of low global interest rates. Should we be worried by these developments?

The forthcoming OECD Economic Outlook special chapter on "Resilience in a Time of High Debt" looks at how high debt-to-GDP ratios can increase vulnerability in the short run. While higher indebtedness does not necessarily imply that problems are just around the corner, it does increase vulnerability to shocks and the on-going deterioration of credit quality, changes in the structure of corporate financing, increased forex risk and buoyant asset price dynamics raise concerns.

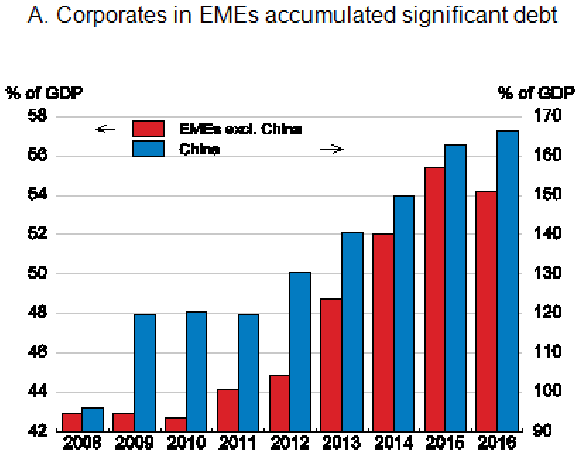
The impact of high debt on the sustainability of growth in the medium term is often overlooked. While finance is needed to support economic activity and innovation, it can increase risks, lower growth, and raise inequality in the longer term.

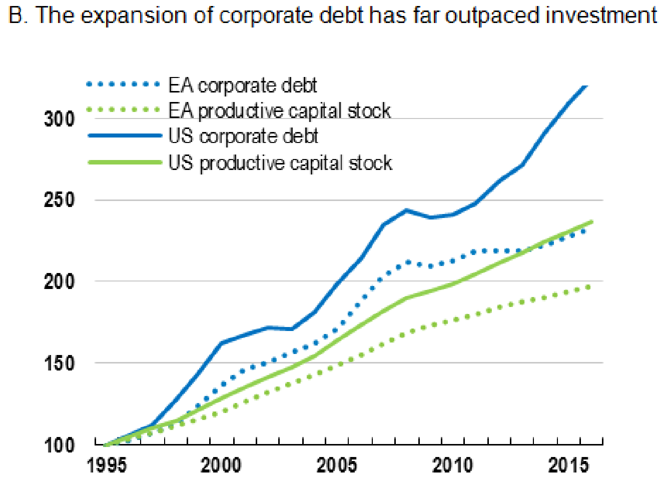
The assessment highlights some key features of the post-crisis expansion of private sector debt for risk:

- There has been a significant shift in corporate finance towards bonds and a substantial decrease in credit quality, including a surge in issuance of non-investment grade bonds, weaker covenants and low bond ratings (Çelik et al., 2015). While deepening of bond markets can be positive, this points to higher credit risk and rollover risk.

- There has been a substantial expansion of international bond markets and foreign-currency borrowing. This helps to share risk and improves access for countries with limited domestic financial markets. However, it increases the risk of international spillovers. The rise in foreign-currency denominated bond issuance – much of which via foreign subsidiaries – exposes borrowers more to exchange rate risk.
- On the asset side, more credit risk now lies with bond holders. They also face interest rate risks and the low level of coupon rates and rising maturity means that there are now record levels of duration risk, implying that bond values are very sensitive interest rate changes.
- Household debt ratios are closely linked to house prices and the credit cycle in mortgages: some OECD countries that have experienced the strongest increases in household debt since the crisis have also the steepest rise in house prices. The housing cycle is an important risk factor as excessive house price developments are predictive signals of future recessions (Caldera Sánchez, et al., 2017). A number of advanced economies have experienced worrying increases in house prices in recent years, while household debt as a share of income in some Asian countries is reaching levels typically seen in advanced economies.

Figure 1





The efficiency of capital allocation is critical to ensure that corporate debt is sustainable and does weigh on medium-term growth. However, weak investment since the crisis raises concerns that debt is not being used to finance long-term productive capacity. Over-indebted firms tend to lose business dynamism, failing to keep up with the required investment to remain competitive, and become "zombie" firms, not only impairing their own prospects but also reducing performance by competing firms (Adalet McGowan et al., 2017).

An integrated policy approach is needed to enhance the financial resilience of economies to shocks and minimise the risks of sub-par growth in the medium term, balancing risks and the growth impacts. This needs to draw on a familiar menu of policy tools including an appropriate balance of macroeconomic policies and use of macroprudential instruments.

However, the approach needs to go beyond cyclical fixes and address underlying structural features of the economy and policy that can lead to too much corporate and household debt. For corporate finance, a sounder and healthier financial system would reduce the tax bias towards debt, deepen equity markets and improve the design of insolvency regimes. For housing markets, removing tax and other subsidies for housing and making housing supply more fluid would enhance the resilience of household debt.

Download Presentation

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