Policy changes to turn the tide

by Laurence Boone, OECD Chief Economist

For the past two years, global growth outcomes and prospects have steadily deteriorated, amidst persistent policy uncertainty and weak trade and investment flows. We now estimate global GDP growth to have been 2.9% this year and project it to remain around 3% for 2020-21, down from the 3.5% rate projected a year ago and the weakest since the global financial crisis. Short-term country prospects vary with the importance of trade for each economy though. GDP growth in the United States is expected to slow to 2% by 2021, while growth in Japan and the euro area is expected to be around 0.7 and 1.2% respectively. China’s growth will continue to edge down, to around 5.5% by 2021. Other emerging market economies are expected to recover only modestly, amidst imbalances in many of them. Overall, growth rates are below potential.

The mix between monetary and fiscal policies is unbalanced. Central banks have been easing decisively and timely, partly offsetting the negative impacts of trade tensions and helping to prevent a further rapid worsening of the economic outlook. Thereby, they have also paved the way for structural reforms and bold public investment to raise long-term growth, such as spending on infrastructure to support digitalisation and climate change. However, to date, other than a few countries, fiscal policy has been only marginally supportive, and not especially of investment, while asset prices have been buoyant.

The biggest concern, however, is that the deterioration of the outlook continues unabated, reflecting unaddressed structural changes more than any cyclical shock. Climate change and digitalisation are ongoing structural changes for our economies. In addition, trade and geopolitics are moving away from the multilateral order of the 1990s. It would be a policy mistake to consider these shifts as temporary factors that can be addressed with monetary or fiscal policy: they are structural. In the absence of clear policy directions on these four topics, uncertainty will continue to loom high, damaging growth prospects.

The lack of policy direction to address climate change issues weighs down investment. The number of extreme weather events is on the rise and insufficient policy action could increase their frequency. They may lead to significant disruptions to economic activity in the short term, and long-lasting damage to capital and land, as well as to disorderly migration flows. Adaptation plans are in their infancy, while mitigation, moving away from fossil fuels, through measures such as carbon taxes, has proved technically and politically challenging. Governments must act quickly: without a clear sense of direction on carbon prices, standards and regulation, and without the necessary public investment, businesses will put off investment decisions, with dire consequences for growth and employment.

Digitalisation is transforming finance, business models and value chains, through three main channels: investment, skills and trade. So far, only a small fraction of businesses appear to have successfully harnessed the strong productivity potential of digital technologies, which partly explains why digitalisation has been unable to offset other headwinds on aggregate productivity. Reaping the full benefits of digital technologies requires complementary investments in computer software and databases, R&D, management skills and training, which remains a challenge for too many firms. Digitalisation is also affecting people and work, because it confers a huge advantage to people whose main tasks require cognitive and creative skills, and penalises those whose work has a large routine element, and at the same time generates new forms of contractual arrangements that escape traditional social protection. But the policy environment to harness new technology – concerning skill upgrading, social protection, access to communication infrastructure, digital platform development, competition in digital markets and regulation of cross-border data flows – lags behind, making it difficult to reap the benefits of digitalisation in full.

The Chinese economy is structurally changing, rebalancing away from exports and manufacturing towards more consumption and services. Increasing self-sufficiency in core inputs for certain manufacturing sectors is reflecting a desire to move away from importing technology towards national production. A shift in energy utilisation to address pollution, and the rise in services also induce additional changes in Chinese demand for imports. China's traditional contribution to global trade growth is set to slow and change in nature. While India is set to grow rapidly, its growth model is different and its contribution to global trade growth will not be enough to substitute for China as a global engine for traditional manufacturing.

Trade and investment are also structurally changing, with digitalisation and the rise of services, but also with geopolitical risks. The rise in trade restrictions is nothing new. About 1500 new trade restrictions have been implemented by G20 economies since the global financial crisis in 2008. Yet, the past two years have seen a surge in trade-restricting measures and an erosion of the rules-based global trading system, which is deep-rooted. Coupled with rising government support across a range of sectors, this induces disruptions in supply chains and reallocations of activities across countries that both exert a drag on current demand by reducing incentives to invest and undermine medium-term growth. Against this backdrop, there is scope and an urgent need for much bolder policy action to revive growth. Reducing policy uncertainty, rethinking fiscal policy, and acting vigorously to address challenges raised by digitalisation and climate change, all have the potential to reverse the current slippery trend and lift future growth and living standards.

First, a clear policy direction for transitioning towards sustainable growth amidst digitalisation and climate challenges would trigger a marked acceleration of investment. Governments should focus not only on the short-term benefits of fiscal stimulus, but primarily on the long-term gains and to this end they should review their investment policy frameworks. The creation of national investment funds, focused on investing in the future, could help governments design investment plans to address market failures and take account of positive externalities for society as a whole. A number of governments already have dedicated funds of the sort, but their governance could be improved to ensure higher economic and social returns on investment.

Second, greater trade policy predictability and transparency could go a long way to reduce uncertainty and revive growth. For instance, there is a need to bring more transparency to the numerous forms of government support that distort international markets and to agree global rules on the transparency, predictability, reduction and prevention of such support.

Third, fiscal and monetary policies can be better activated, and to powerful effect if coordination prevails. There is scope to strengthen automatic stabilisers to preserve household income and consumption. Active coordination across the euro area would contribute to lift growth now. Moreover, should the outlook deteriorate more than we project, coordinated fiscal and monetary action across the G20, even allowing for the limited policy space some central banks have, could efficiently avert a recession, not least because coordination would bolster confidence.

The current stabilisation at low levels of economic growth, inflation and interest rates does not warrant policy complacency. The situation remains inherently fragile, and structural challenges – digitalisation, trade, climate change, persistent inequalities – are daunting. Rather, there is a unique window of opportunity to avoid a stagnation that would harm most people: restore certainty and invest for the benefit of all.

http://oecd.org/economic-outlook/

Competition in the digital age

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Digital technologies have the potential to bring huge benefits in terms of productivity, jobs and ultimately living standards. At the same time, consumers will gain access to new, innovative, and cheaper products. However, for digitalisation to bring benefits to all firms and citizens, we need a healthy competitive environment, which encourages and diffuses innovation, and helps bring the gains from technology to people.

There is a growing debate in the media and among policymakers about how competition is functioning in digital markets, with a focus on market power, concentration and data protection, among other concerns. The OECD's analysis is beginning to shed light on this important issue, and develop policy options to harness the benefits of digitalisation.

To start with, let's recall what makes digital markets unique and shapes the business models and competitive dynamics in digital sectors. These characteristics include:

- **Substantial network effects** in platform markets, meaning that as the number of users grows, the value of a platform to users increases.
- **Low variable costs and high fixed costs,** meaning that there are significant economies of scale and scope in digital markets.
- **Data from users playing an increasingly important role** as an input and competitive asset. New firms may find that data constitutes a substantial barrier to entry in digital markets, and consumers may not be fully aware of the data collected when they use online services.

These characteristics can result in a small number of firms holding very high market shares and potentially dominant positions in some digital markets.

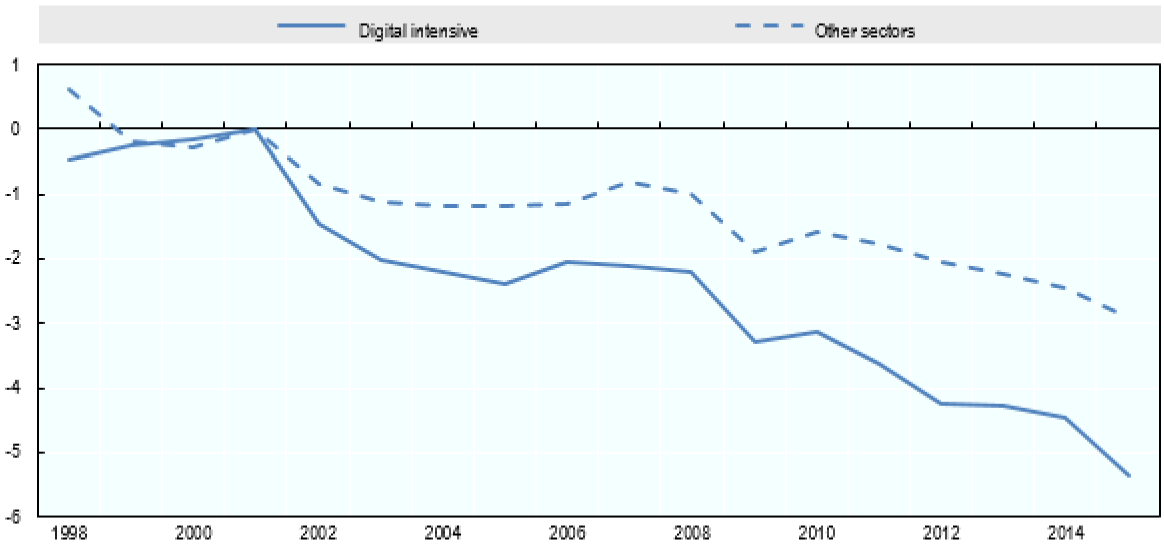
However, it is important to recognise that a firm having a large share of a given market is not automatically a cause for concern. In fact, it may simply be the reward for having the most innovative ideas, or attracting the highest number of users to increase the usefulness of a digital platform. As long as the large market share is not defended through anticompetitive conduct, and the market is accessible enough for new entrants, the market can function well.

However, there are some signs that markets are becoming less dynamic than before

- First, the OECD and others have found that mark-ups (defined as the ratio of unit price over marginal cost) charged by firms are increasing. This could be an indicator that competitive intensity is weaker than before.

- Second, there is evidence that fewer start-ups are being created, particularly in the digital sector, which also has implications for the entrenchment of large firms, as shown in Figure 1 below.

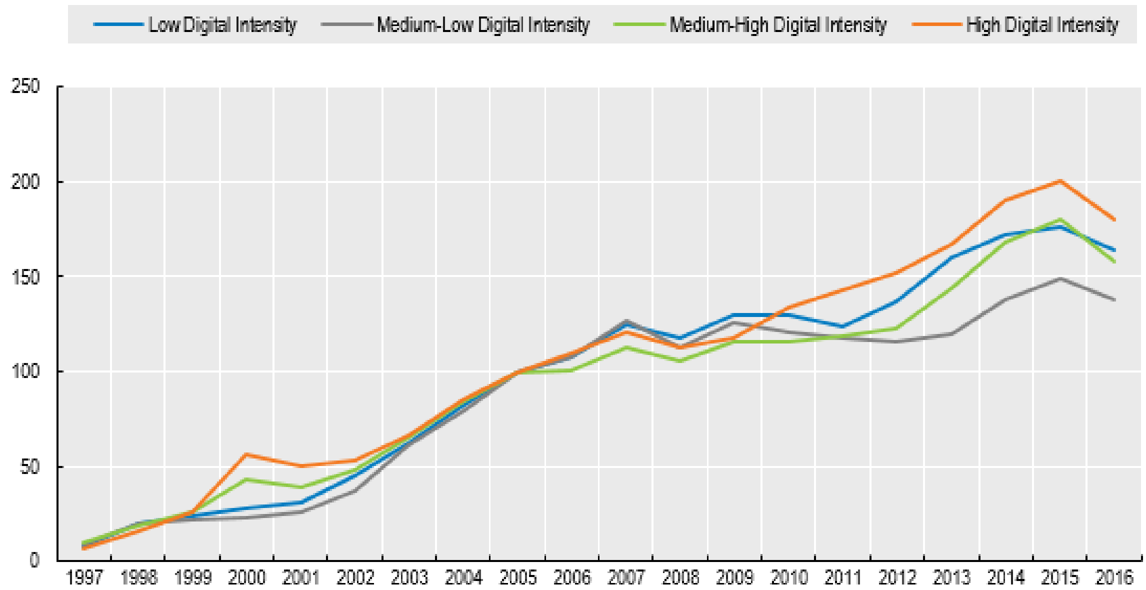
Figure 1: Falling firm entry rates



Source: Calvino and Criscuolo (2019) based on the OECD DynEmp3 database
Note: The figure reports average within-country-industry trends based on the year coefficients of regressions within country-sector, with and without interaction with the digital intensity dummy. Digital intensive sectors are reported with a blue line and other sectors with an orange line. The dependent variables is entry rates in panel. Each point represents cumulative change in percentage points since 2001.

- Third, there has been an acceleration of M&A activity that focuses on digital firms (see Figure 2 below). Many mergers can have broadly procompetitive benefits, for example in terms of innovation. But there is concern about transactions involving small start-ups that are not captured by competition authorities, and which may have anticompetitive effects.

Figure 2: Number of M&As per Year by Digital Intensity of the Target Firm



Note: The digital intensity of sectors is defined using the industry of the target firm and the STAN A38 global digital intensity indicator of 2013-15 constructed by (Calvino et al., 2017). The M&A data reflects the annual total number of acquisitions (i.e. result in a majority stake), purchasing minority stakes and issuing of new share capital involving target firms in the non-farm non-financial business sector (i.e. NACE rev.2 codes 10-82, excluding 64-66). Note M&A data has global coverage from 2003 onwards, statistics before that point should be interpreted cautiously.
Source: Zephyr M&A database

- Fourth, there are signs that the largest firms are earning an increasing share of revenues. While revenue concentration is not a very meaningful indicator of competition on its own, in combination with the other evidence above, it may suggest that something is changing about competitive dynamics in markets.

The OECD is working to understand the implications of these findings, especially the role of digitalisation. There is currently no single “smoking gun”, whether technological entry barriers, regulatory distortions to competition, or firm misconduct. A variety of factors may be at play.

In the meantime, policymakers can take steps to address competition risks in digital markets.

First, there are opportunities to strengthen competition law enforcement. Agencies may need to adjust merger notification thresholds to ensure they capture potentially anticompetitive acquisitions of digital start-ups. They will also require vigilance in assessing merger harms associated with dynamic competition (i.e. effects on potential future competition) and innovation, as well as addressing potential abusive conduct by firms. Ex-post assessments of merger decisions can also help authorities review the analysis and tools used in past cases in order to draw lessons going forward. Authorities may also need additional tools to analyse and detect novel forms of firm misconduct, such as algorithmic collusion.

Second, we need to consider whether current legislative frameworks are themselves contributing to problems regarding digital competition. For example, the OECD is adapting its Competition Assessment Toolkit to assist policymakers in identifying regulatory barriers to competition in digital sectors. The adapted toolkit for digital markets will be released later this year.

Third, new policy solutions may be needed to protect and promote competition in digital markets, such as data portability measures. Such measures could potentially help innovative new firms overcome the barriers to entry associated with data, and empower consumers by reducing switching costs. New business models could emerge that involve paying consumers for their data, allowing them to share in the value generated by their online activities.

Consumer and data protection regulators can also address growing consumer concerns about digital firms while at the same time promoting competition. This can include clarifying the rights consumers have, and ensuring that they are given meaningful opportunities to exercise those rights through fair contracting standards and default options

Fourth, competition authorities can strengthen cooperation with international counterparts given the global scale of many digital businesses. Investigation and advocacy cooperation is also needed with consumer protection and data protection authorities, who may be dealing with overlapping concerns. The OECD has a range of resources for competition authorities on emerging digital competition issues, assessing their past decisions, and using non-enforcement tools.

More broadly, policymakers must

ensure that the fundamentals are in place for new businesses to succeed, namely
by ensuring the right skills mix in the economy, keeping administrative burdens
to a minimum, and promoting broadband internet access.

OECD will be jointly hosting with the French Ministry of the Economy and Finance, and the French Autorité de la concurrence, a conference exploring many of these issues on June 3, 2019. The conference, Competition in the Digital Economy, will be webcast, and available to watch during and after the event here.

Further reading

Bajgar, M., et al. (2019), "Industry Concentration in Europe and North America", *OECD Productivity Working Papers*, No. 18, OECD Publishing, Paris, https://doi.org/10.1787/2ff98246-en.

Calvino, F. and C. Criscuolo (2019), "Business dynamics and digitalisation", *OECD Science, Technology and Industry Policy Papers,* No. 62, OECD Publishing, Paris, https://doi.org/10.1787/6e0b011a-en.

More resources on the digital economy, innovation and competition