Speeding up economic catch-up in the BRIICS with better governance and more education

Category: education,Uncategorized
written by oecdecoscope | September 17, 2018
by Yvan Guillemette, Macroeconomic Analysis Division, Economics Department

Economic research has established that a large part of income disparities between poor and rich countries can be attributed to differences in governance and in the quantity and quality of human capital. In the latest long-run reference scenario published by the OECD, GDP per capita growth is relatively strong in the BRIICS in the coming decades, but living standards nevertheless remain less than half those of the United States in 2060, in part because of remaining gaps in governance and educational attainment. But the BRIICS can accelerate economic catch-up by improving these aspects of the economic environment, as demonstrated in an alternative scenario.

The quality of governance depends on a cluster of related institutions, including economic, political, legal and social aspects. In the model behind the long-run projections, institutional quality is proxied by a rule of law index, one of six governance indicators regularly updated by the World Bank. It is a perceptions-based index intended to capture "…the extent to which agents have confidence in and abide by the rule of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence". In the model, improved governance not only raises productivity in the long run, but it also boosts the speed at which the full long-run effects of reforms are attained, including in other domains,

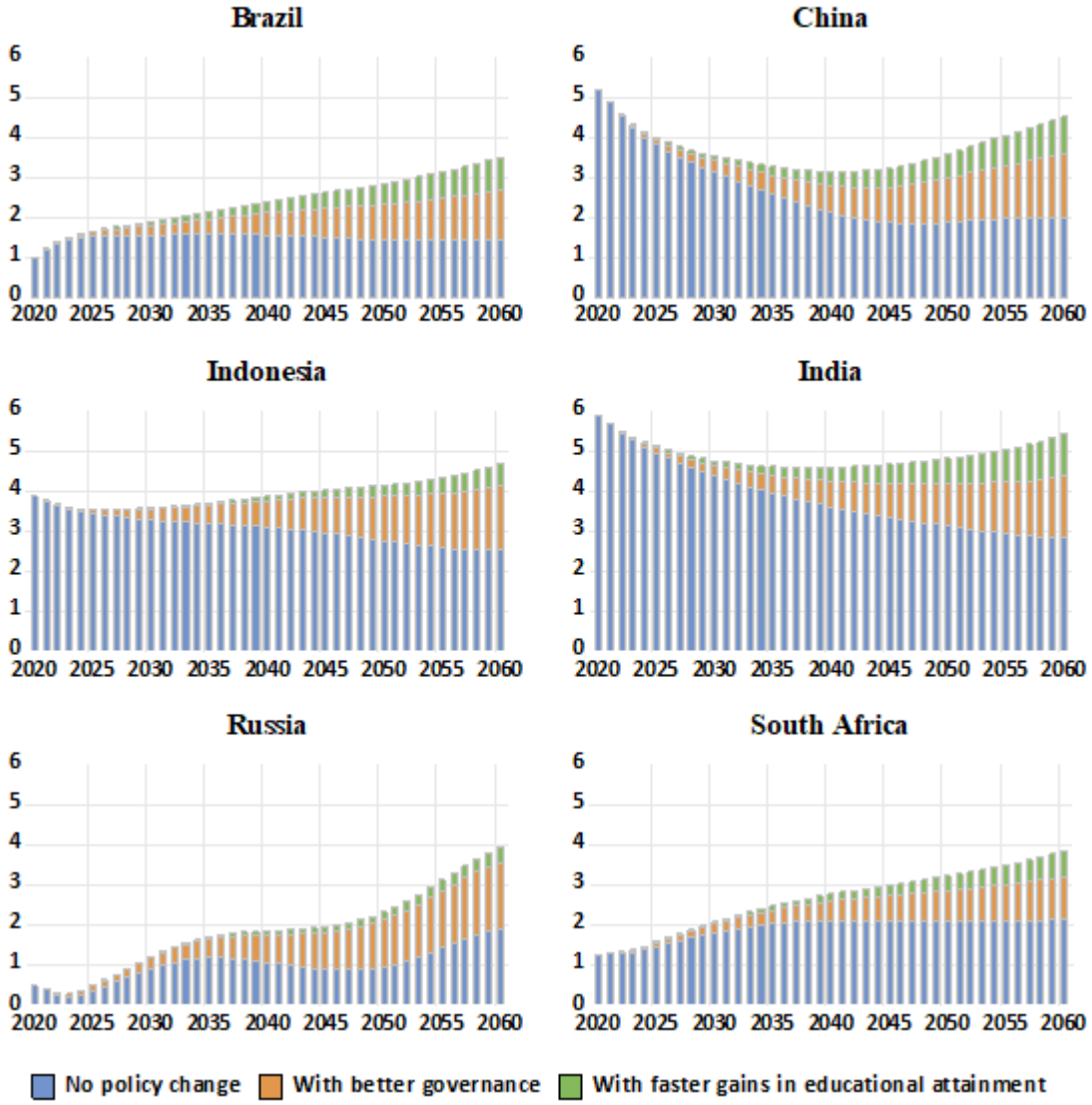
such as education.

Education not only embeds knowledge and skills in individuals, raising their productivity, but it also encourages participation in groups, opens doors to job opportunities, develops social interactions, makes individuals better aware of their rights, improves health, reduces poverty and facilitates the sharing and transmission of knowledge needed for developing new technologies.

The potential for reforms in these areas to improve long-run economic prospects in the BRIICS can be illustrated by comparing the reference scenario – featuring no change to governance and only a "most likely" evolution of educational attainment – with an alternative scenario in which governance is strengthened and bigger gains in educational attainment are made. The alternative scenario assumes that rule of law scores and mean years of schooling in the BRIICS catch up to the OECD medians over the 2020-to-2060 period.

Better governance and higher educational attainment raise an economy's productivity, allowing living standards to rise. The gains build up slowly over time but by 2060, annual growth in living standards in the BRIICS is roughly 2 percentage points higher than in the reference scenario (see figure), and levels are between 30% and 50% higher. The positive *growth* impacts from the reforms would start tapering off gradually after 2060 while the *level* impacts would continue to accumulate, corresponding to the long lags involved in benefitting fully from structural reforms. In terms of relative importance, strengthening governance makes the largest contribution in this alternative scenario, with two thirds of the aggregate BRIICS effect. It is particularly important in Russia, while Brazil, China and India also have much to gain by improving educational attainment.

Projected annual growth in living standards (real GDP per capita) in the BRIICS, per cent



The results underscore the importance for the BRIICS of targeting education and governance as areas for improvement, and of taking a long-term view of their importance for growth and well-being. And while the BRIICS are used here for illustrative purposes, other countries could similarly benefit from faster gains in education and from governance reforms. Notably Argentina, Colombia, Mexico and Turkey score relatively low on governance.

Further reading:

Guillemette, Y. and D. Turner (2018), "The Long View: Scenarios for the World Economy to 2060", *OECD Economic Policy*

Papers, No. 22, OECD Publishing, Paris, https://doi.org/10.1787/b4f4e03e-en.

Gönenç, R. (2017), "The middle income plateau: Trap or springboard?", *OECD Economics Department Working Papers*, No. 1446, OECD Publishing, Paris, https://doi.org/10.1787/9cba114b-en.

Statistical Insights: An x-ray view of inflation

Category: Statistical Insights,Uncategorized
written by oecdecoscope | September 17, 2018



By Pierre-Alain Pionnier, Francette Koechlin, Anne-Sophie Fraisse and Elena van Eck.

Inflation may be present in some parts of an economy but not others. Contributions to annual inflation show how much different product groups contribute to overall inflation in a given year.

The measure is a useful tool to understand where inflation is occurring in different countries, analyse trends in inflation over time, and identify volatile and stable components of inflation. It may also help explain why consumers' perceptions of inflation sometimes differ from official figures.

This Statistical Insight uses figures for Germany, Japan and the United States (US) to illustrate the usefulness of data on contributions to inflation.

Analysing inflation by component

In addition to aggregate national Consumer Price Indices (CPIs), the OECD provides data on the contributions to annual inflation of 12 standard product groups and special aggregates.

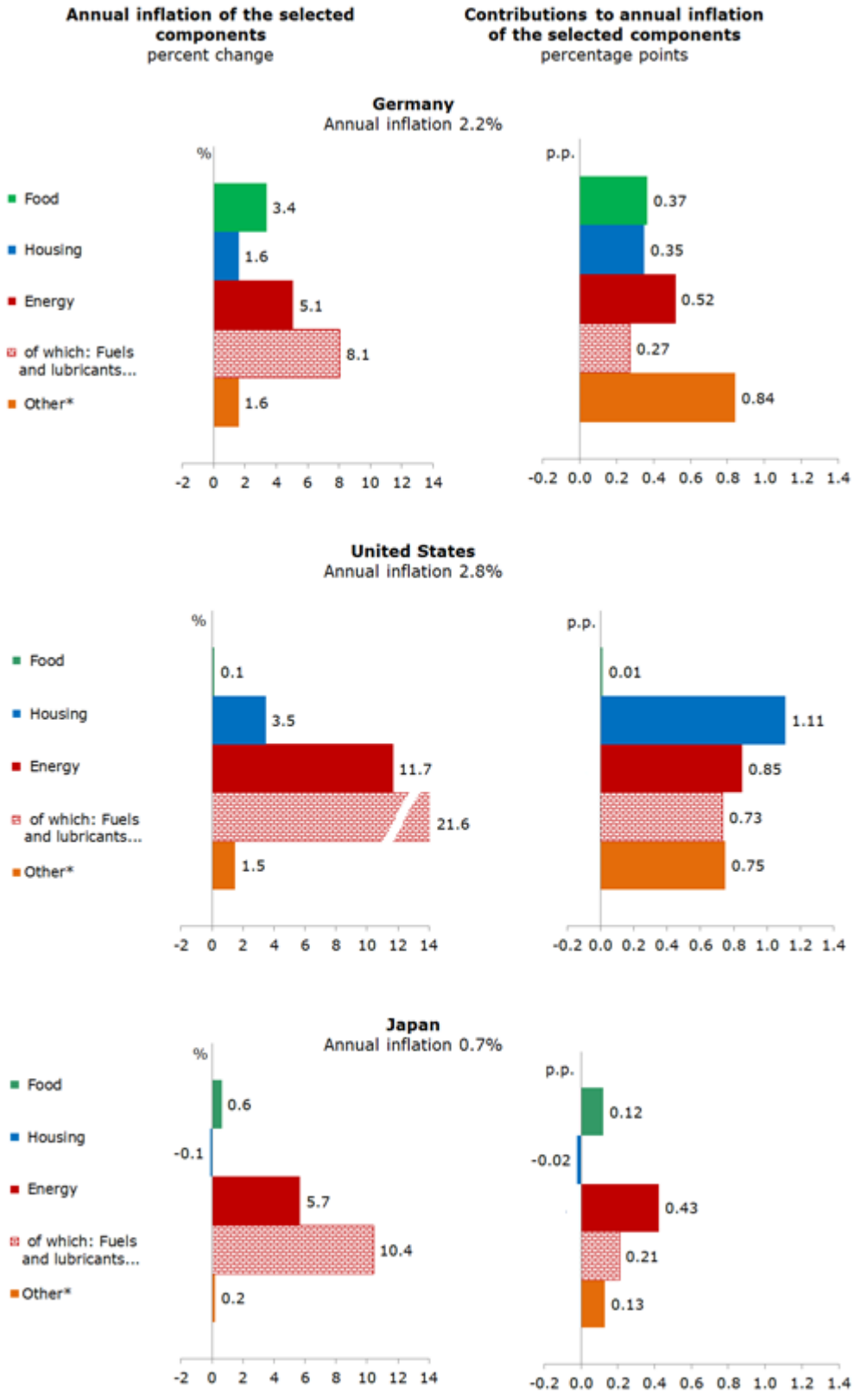
Figure 1 shows that in Germany, Japan and the US, aggregate inflation hides wide variations in price movements across product groups. In Germany, while overall prices increased by 2.2% in the year to May 2018, food and housing prices increased by 3.4% and 1.6% respectively. In the US, energy prices increased by 11.7%, and gasoline prices by 21.6%, while overall prices only increased by 2.8%.

The contribution of a given product group to overall inflation depends both on the price change of the relevant product group and on its share in consumers' expenditures. The shares vary between countries. For example, households spend around 20% of their incomes on housing in Germany and Japan, but over 30% in the US. The high share of housing costs in US households' budgets meant that price changes in those costs contributed most to overall US inflation in the year to May 2018, even though energy prices rose much faster than housing prices. In fact, energy prices shot up everywhere, but only in Japan was energy the largest contributor to overall inflation.

It may also be the case that consumers are more sensitive to

movements in the prices of items they purchase frequently. For example, they may feel that inflation is high if the prices of food items are rising quickly, even though food products and non-alcoholic beverages represent less than 10% of households' expenditures in the US, around 10% in Germany, and less than 20% in Japan.

Figure 1. Annual inflation rate (%) and contributions of selected components May 2018, Germany, United States and Japan



* Alcoholic beverages, tobacco and narcotics (COICOP 02), Clothing and footwear (COICOP 03) Water supply and miscellaneous services relating to the dwelling (COICOP 0404); Furnishings, household equipment and routine household maintenance (COICOP 05); Health (COICOP 06); Transport (COICOP 07 less COICOP 0702); Communication (COICOP 08); Recreation and culture (COICOP 09); Education (COICOP 10); Restaurants and hotels (COICOP 11); Miscellaneous goods and services (COICOP 12).

Source: OECD (2018) Consumer prices (database)

Recent trends in overall and core inflation (2012-2018)

Because food and energy make volatile contributions to inflation, economists often focus on a consumption basket that excludes them in order to better understand and forecast long-term developments in inflation. The resulting numbers are called underlying, or core, inflation.

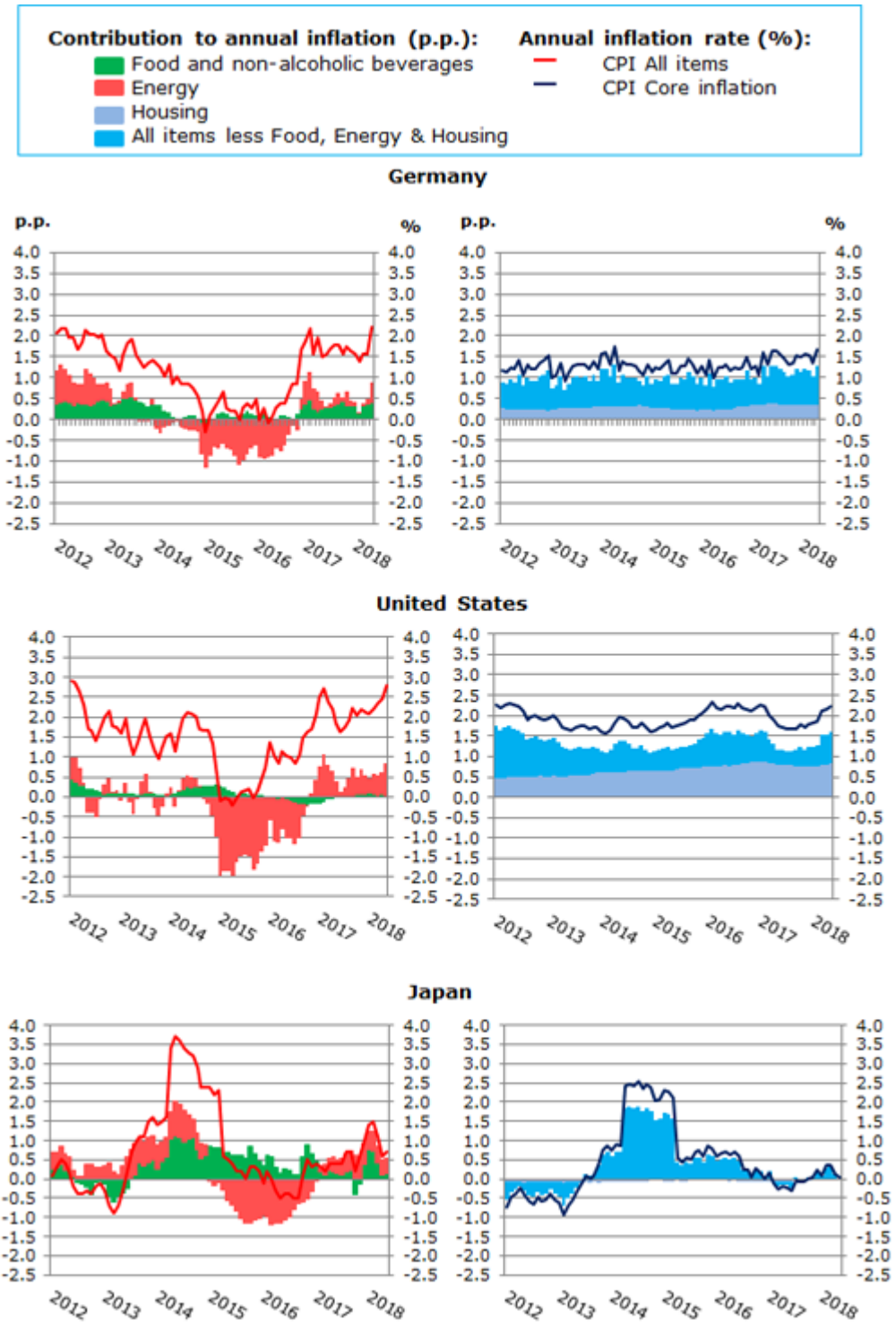
Figure 2 shows that energy contributed to the bulk of inflation fluctuations between 2012 and 2018. Changes in energy prices are dominated by movements in world crude oil prices, but exchange rate fluctuations also play a role because oil prices are usually fixed in US dollars. In 2015, for example, oil prices fell but at the same time the euro and the yen depreciated against the US dollar, so that oil prices in those currencies did not fall as much as they did in dollars. This meant that falling oil prices did not reduce inflation as much in Germany and Japan as in the US.

Even after excluding volatile food and energy prices, core inflation rates vary significantly across countries. Figure 2 shows that core inflation in Japan has long been lower than in Germany and the US, except for a blip in 2014-15 caused by a hike in value-added tax. Since 2016, core inflation in the US has also been consistently higher than in Germany. The major contributor to these differences is housing prices, which have risen faster in the US than in Germany, and faster in Germany than in Japan. Note that housing prices correspond to housing rentals (including imputed rentals for owner-occupied dwellings) and maintenance costs. This ignores the purchase prices of houses and apartments, which are considered as investments rather than consumption and are covered by separate price indices.

Figure 2. Annual inflation rates (%) and contributions of

selected components (percentage points)

2012-2018, Germany, United States and Japan



Source: OECD (2018) Consumer prices (database)

The measure explained

Contributions to annual inflation represent the contributions to overall inflation in percentage points by different product groups. The contribution of each product group depends both on the price change in the relevant product group and its weight

in households' expenditures.

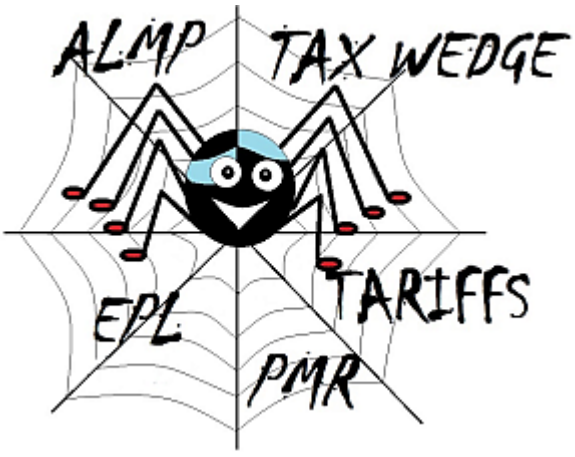
The OECD calculates contributions to inflation based on national data for all countries except Austria, Chile, Finland, Mexico, the Netherlands, Poland, Sweden, and the United Kingdom, whose National Statistics Offices provide the data directly. For further information please see OECD CPI FAQs.

Where to find the underlying data

- Access contributions to annual inflation

Structural Policy Indicators Database for Economic Research: SPIDER on the web

Category: Structural reform,Uncategorized
written by oecdecoscope | September 17, 2018
by Égert Balázs, Peter Gal and Isabelle Wanner, OECD Economics Department



Researchers looking for empirical evidence on the relative impact of policy and non-policy drivers of economic growth know how much time and efforts can go into assembling a large database of policy variables and other determinants covering as many countries and years as possible. Even when such database can be patched-up

from tapping into earlier studies, up-dating the series often requires going through a vast number of different data sources. Thanks to a recent OECD initiative, such task could be greatly facilitated from now on. A new OECD's Structural Policy Indicators Database for Economic Research (SPIDER) is now available online and provides a broad range of data to researchers in ready-to-use formats to facilitate empirical/econometric research investigating the nature and the impact of structural policies. Available as a text file (TXT), STATA (.dta) and Eviews (.wf1) formats, the database includes about 500 policy and institutional indicators from almost 50 different OECD and non-OECD data sources. The policy variables stored in the database are annual or less frequently available (every five years or only once). The database will be updated on a yearly basis.

The database covers the following broad categories of policy variables: i) ***legal infrastructure and institutions*** describe features of the political system, the underlying legal institutions and indicators measuring the quality and various aspects of public governance; ii) ***framework condition policies*** include policies that condition the environment in which firms operate and make decisions such as the product market regulation (PMR/ETCR) indicators, the competition law and policy (CLP) indicator and a number of labour market institutions; iii) s***pecific policies*** cover policies relating for instance exclusively to specific segments of the labour market (older workers, women or the youth) and include family benefits, policies influencing decisions to retire. Examples of other specific policies are measures primarily designed to support R&D investment or exports. Table 1 gives an overview on the main categories of variables included in SPIDER.

Table 1. **The main categories of variables included in SPIDER**

LEGAL AND POLITICAL INSTITUTIONS	CHANNEL-SPECIFIC POLICIES & INTERMEDIATE OUTCOMES
Political system	Innovation policies (proxies for)
Judicial system	Unemployment benefits
Governance	Activation policies
FRAMEWORK CONDITIONS, REGULATIONS AND POLICIES	Pension system
Labour market regulation	Family and child policies
Product market regulation	Immigration
Doing business	Gender
Competition, Law and Policy	Financial development
Housing	Health
Wage setting	Education and skills
Non-labour taxation	**COUNTRY CHARACTERISTICS**
Labour taxes	Geography
	Social values
	Demography
	History
	Language/Ethnicity/Religion

Aimed primarily at helping researchers to kick-start empirical analysis by keeping the costs of assembling the required data very low, the usefulness of the SPIDER database to economic research can be demonstrated through the range of possibilities it offers in terms of assessing the impact of institutions and policies in growth regressions. For instance, it allows for runing cross-country time series growth regressions for OECD countries including indicators of product and labour market regulations with about 20 to 30 years of data. As an illustration, the scope of variables that can be included in several variants of growth regressions.

The analysis can also be extended to non-OECD countries, although in that case the time series dimension of the data will likely to be shorter and regulations and institutions will be measured by indicators available from non-OECD data sources. Finally, for purely cross-sectional regressions, with a very large set of indicators that also capture the geographical, social and cultural aspects, the number of

observations reach about 90. These examples indicate the scope of the database for such an exercise.

Aside from facilitating cross-country/time-series empirical analysis, the new database is a one-stop shop where a large set of internationally comparable policy variables can be found and used to gauge in a more descriptive manner the magnitude of structural reform actions in specific countries and areas over a broad range.

References:

The database is described in more detail in Égert, Gal and Wanner (2017), “Structural policy indicators database for economic research (SPIDER)”, OECD Economics Department Working Paper No. 1429.

The UK productivity puzzle through the magnifying glass: A sectoral perspective

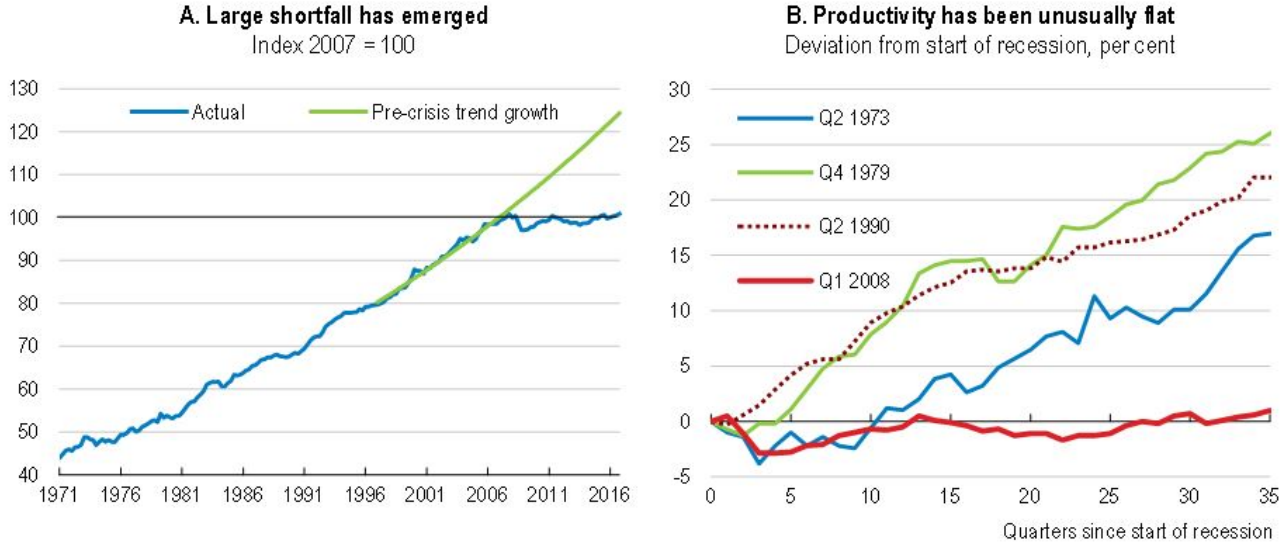
Category: Labour markets,Productivity,Uncategorized,United Kingdom
written by oecdecoscope | September 17, 2018
Rafał Kierzenkowski, Gabriel Machlica and Gabor Fulop, Economics Department.

Labour productivity has flatlined since the global financial crisis, which contrasts with its recovery profiles from past recessions over the last decades (Figure 1). The productivity shortfall, defined as the gap between actual productivity and the level implied by its pre-crisis trend growth rate, reached nearly 20% at the end of 2016. This unprecedented levelling

off represents the so-called productivity puzzle, with the level of output being surprisingly weak relative to high total hours worked in the economy. At the aggregate level, the weakness in productivity is driven by subdued investment developments and total factor productivity, and this underperformance appears to be mainly structural rather than cyclical.

Figure 1. Labour productivity has disappointed since the financial crisis

Output per hour[1]



1. Output refers to real gross value added. Pre-crisis trend growth is calculated between 1997 and 2007, and is projected from 2008 onwards.

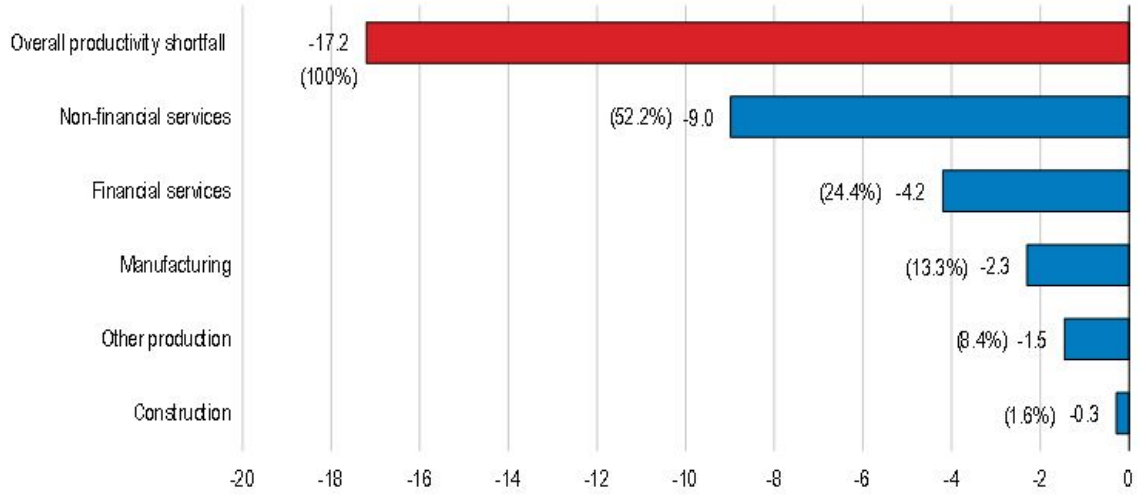
Source: OECD calculations based on ONS (2017), "Labour productivity: Oct to Dec 2016", Office for National Statistics, April.

Using disaggregated data at the sectoral level provides additional insights about the determinants of the productivity puzzle, as shown in a recent OECD Economics Department Working Paper (Kierzenkowski et al., 2018). There has been a marked increase in the dispersion of productivity performance across UK sectors since the crisis, with sectors lagging behind becoming even more disconnected from the best-performing sectors (at a given point in time). Moreover, the aggregate productivity slowdown appears to be mainly driven by the weakness in productivity within each sector, which suggests sector-specific determinants of the productivity shortfall.

To investigate the issue further, it is possible to calculate the contribution of each sector to the aggregate productivity shortfall since 2007. Such calculation shows that half of the gap is explained by non-financial services (with information and communication being the largest contributor), a fourth by financial services, and another fourth by manufacturing, other production and construction (Figure 2). All but non-financial services and the construction sectors contribute disproportionately to the productivity shortfall compared to their shares in overall output and hours worked of the UK economy.

Figure 2. Services sectors account for a large share of the productivity shortfall

Contributions of sectors to the productivity shortfall relative to 1997-2007 trend growth, percentage points and percentages in brackets, Q4 2016[1]



1. Other production refers to agriculture, forestry and fishing (section A), mining and quarrying (section B), electricity, gas, steam and air conditioning supply (section D) and water supply, sewerage, waste management and remediation activities (section E). Imputed rental is excluded from the gross value added of real estate activities.

Source: OECD calculations based on ONS (2017), "Quarterly National Accounts: Oct to Dec 2016", Office for National Statistics, March; and ONS (2017), "Labour Productivity: Oct to Dec 2016", Office for National Statistics, April.

In non-financial services, large increases in self-employed with no employees may have reduced the economies of scale and scope of organised work (Figure 3, Panel A), while the production of the sector has become less capital-intensive at the same time. Greater mismatches between changing skills and

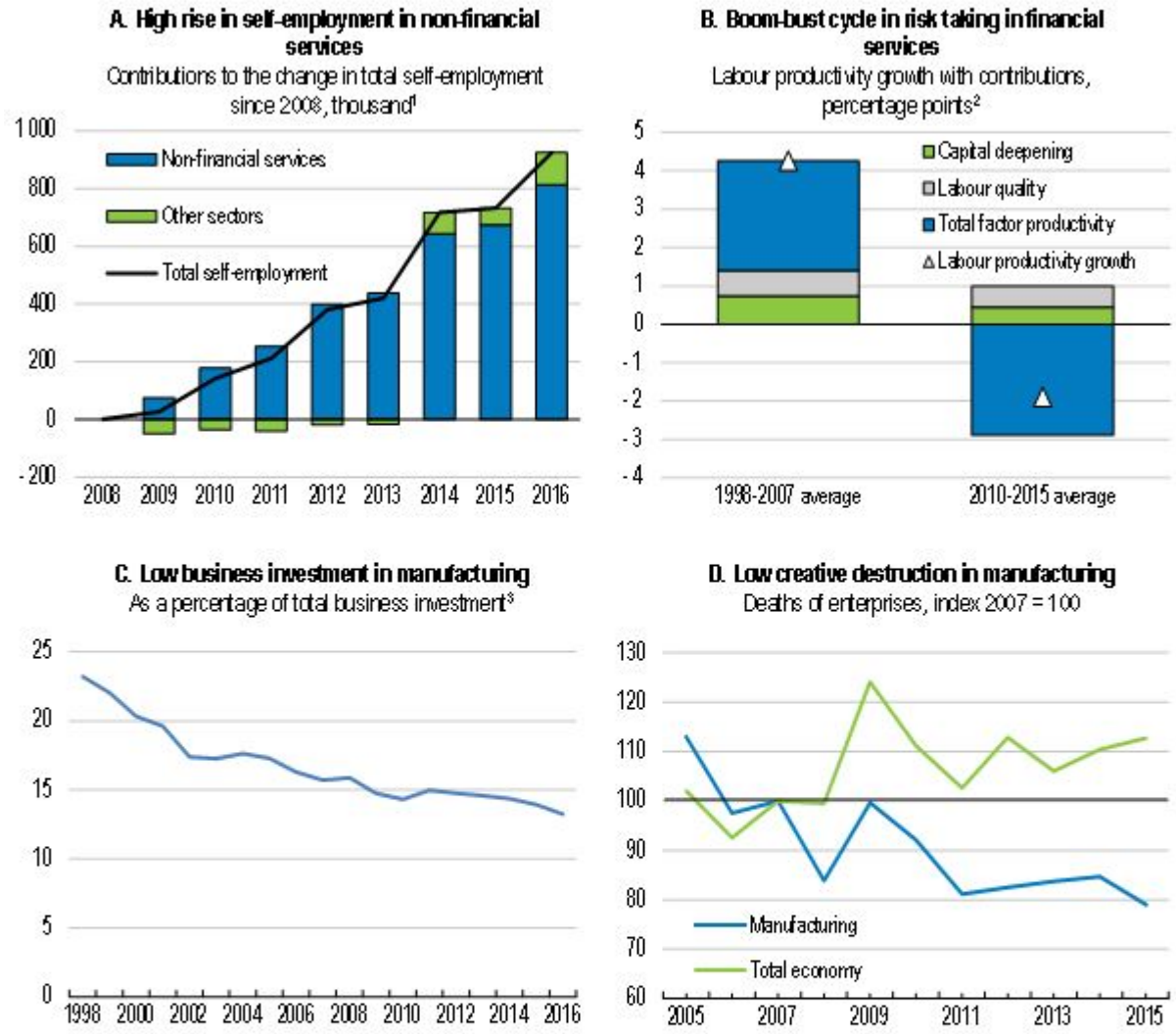
created jobs may have also curbed productivity growth, in particular in the information and communication sector where many high-skilled occupations have been created but where increases in labour quality have been comparatively weak.

In financial services, stagnant labour productivity is mainly linked to reduced risk-taking and leverage, as reflected by the decline in total factor productivity following its steep increases in the run-up to the crisis (Figure 3, Panel B). Although the measurement of output of the financial sector is difficult, this finding is corroborated by the relative size of the financial sector, which was expanding quickly to become significantly larger than in the rest of the G7 in the run-up to the crisis. Looking ahead, the key issue is the extent to which the financial sector can add to productivity growth of the UK economy without undermining financial stability.

In manufacturing, low accumulation of the capital stock (Figure 3, Panel C), suggests a greater substitution from capital towards labour in the production process and a drag on the productivity of the sector. Also, there are indications that weak corporate restructuring may have been another driver, with company exits being smaller than in the overall economy (Figure 3, Panel D). Particularly, in low-tech manufacturing , the percentage of capital and labour that is held up by zombie firms (defined as firms which persistently fail to cover their interest payments from current profits) is estimated to be respectively at around 18% and 13% (OECD, 2017).

The UK productivity puzzle is also partly explained by pre-crisis developments, which include a low tangible investment in comparison with other OECD countries, a too rapid expansion of the financial sector despite the comparative advantage of the City, productivity gains in the manufacturing sector that were insufficiently “offensive” (driven by innovation), and a secular decline of the oil and gas sectors with dwindling resources in the North Sea.

Figure 3. Some possible drivers of the UK productivity puzzle at the sectoral level



1. Data refer to population aged 15 and over.
2. Labour productivity is defined as output (i.e. real gross value added) per hour worked. Contributions to labour productivity growth are calculated using a factor augmenting production function with a weight of 0.59 for hours worked and labour quality while total factor productivity is calculated as a residual. Capital deepening refers to net capital stock per hour worked. Labour quality is measured as the difference between the quality adjusted labour input (QALI) and hours worked.
3. In real terms. Data refer to private sector investment.

Source: Eurostat (2017), "Employment and Unemployment (Labour Force Survey)", *Eurostat Database*, May; and OECD calculations based on data from Office for National Statistics.

References:

Kierzenkowski R., G. Machlica and G. Fulop (2018), "The UK productivity puzzle through the magnifying glass: A sectoral perspective", *OECD Economics Department Working Papers*, No 1496, OECD Publishing.

OECD (2017), *OECD Economic Surveys*: United Kingdom 2017, OECD

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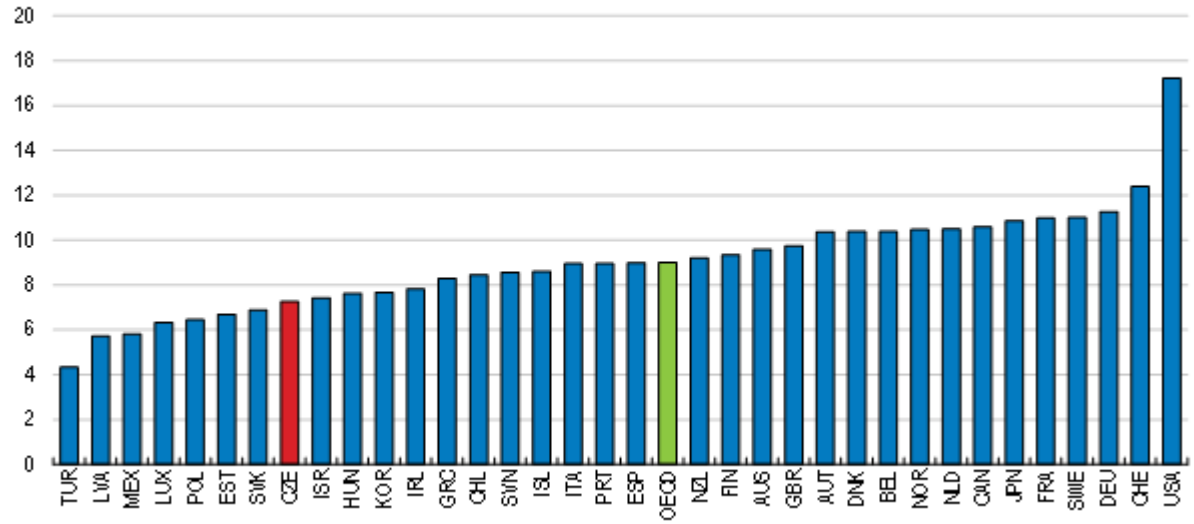
Improving the Czech health care system

Category: Czech Republic,Uncategorized
written by oecdecoscope | September 17, 2018
by Falilou Fall, Czech Republic desk, OECD Economics Department



Health outcomes in the Czech Republic have improved considerably over the last decade. Life expectancy rose by 2.6 years to 78.7 years between 2005 and 2015 towards the OECD average of 80.6 years. This was achieved with relatively low expenditures on health care of about 7% of GDP. However, the population is ageing challenging the financial sustainability of the health care system. As the old-age dependency ratio deteriorates, so do revenues of the health care system as they rely heavily on social security contributions of the working population. Ageing is expected to account for roughly half of the future rise in health care spending, which would reach about to 40% of the government budget by 2060 (OECD 2018).

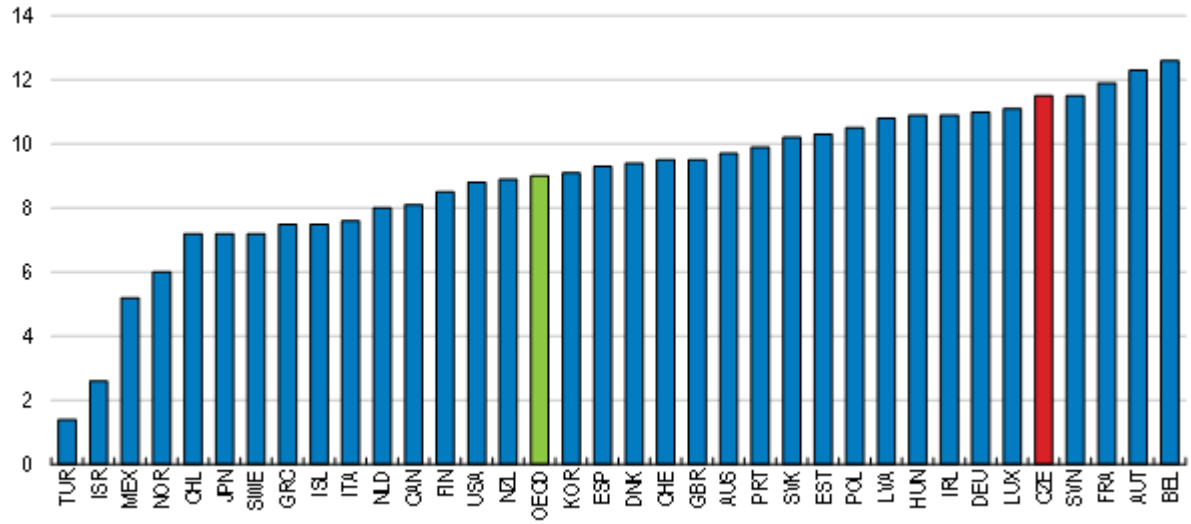
Figure 1. Total health care expenditure, 2016, % of GDP



Source: OECD (2017), Health at a Glance 2017: OECD Indicators, OECD Publishing, Paris

To maintain and improve health outcomes and to set a basis for healthy ageing, healthier lifestyles need to be promoted. Risky behaviour, such as smoking, alcohol consumption and obesity are close or above the OECD average. Excise taxes on alcohol are among the lowest in the OECD, contributing to the relatively high alcohol consumption that reached 11.5 litres per capita in 2015 – compared to an OECD average of 9 litres per capita. Price incentives through higher taxation of tobacco, alocohol and unhealthy food and beverages could reduce consumption. Policy measures to promote healthier lifestyles should however follow an integrated approach beyond tax incentives and include further development of health education, disease prevention and screening programmes.

Figure 2. Alcohol consumption, litres per capita, 2015



Source: OECD Health Statistics 2017

A well functioning primary care sector can bring both efficiency gains through reducing avoidable use of hospital facilities, and better quality of care through better management of patients' pathways. However, in the Czech Republic, the efficiency of delivery of primary care is suffering from lack of co-ordination. Patients' ability to access specialist care without a prior general practitioner (GP) consultation, poorly defined mutual responsibilities of outpatient specialists and GPs and current payment systems mean that primary care's potential to lead for instance chronic disease management is not being fulfilled. GPs should be entrusted with a greater gate-keeping and co-ordination role to ensure that patients are better directed to the most appropriate place for their treatment. User fees for specialist visits without referral could be introduced to strengthen GP's gate-keeping role.

As the economy is doing well, reforms to the health care system and its financing should be adressed now. The Czech health system is heavily regulated by the government through the Reimbursement Decree. Through this decree, most prices and volume limitations of activities of health providers are set. Having a genuine negotiation process between health care providers and insurance funds would help reduce some of the

inefficiencies in service delivery. Overall, there is a need to rebalance the system towards more competition between health providers and insurance funds and private funding to improve quality, efficiency and reduce the reliance on public funding.

References:

OECD (2018), OECD Economic Surveys: CZECH REPUBLIC 2018, OECD Publishing

OECD (2017), Health at a Glance 2017: OECD Indicators, OECD Publishing, Paris

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Rising financial integration amplifies the global impact of financial market shocks

Category: Economic outlook,Uncategorized
written by oecdecoscope | September 17, 2018
by Nigel Pain and Véronique Salins, OECD Economics Department



Stronger cross-border economic and financial integration implies that macroeconomic shocks in one country are increasingly likely to spill over into other economies. This is particularly true in national financial markets, where developments increasingly reflect common underlying factors, as shown in the special chapter of the latest OECD Economic Outlook. Thus, a change in risk sentiment in a major market, such as the United States, may

spread quickly to other markets, with implications for activity and economic policy.

This is illustrated below, using simulations based on the global macro model NiGEM. The shock considered is a 1 percentage point rise for two years in the US equity risk premium – the compensation investors require for taking on more risk by investing in equities. To isolate financial transmission channels we assume that agents have adaptative expectations and exchange rates are fixed[1]. By itself the shock is relatively modest, reducing US equity prices (relative to baseline) by around 10%. However, linkages between financial markets around the world mean that the shock spreads to other markets, to an increasing extent over time as the linkages deepen.

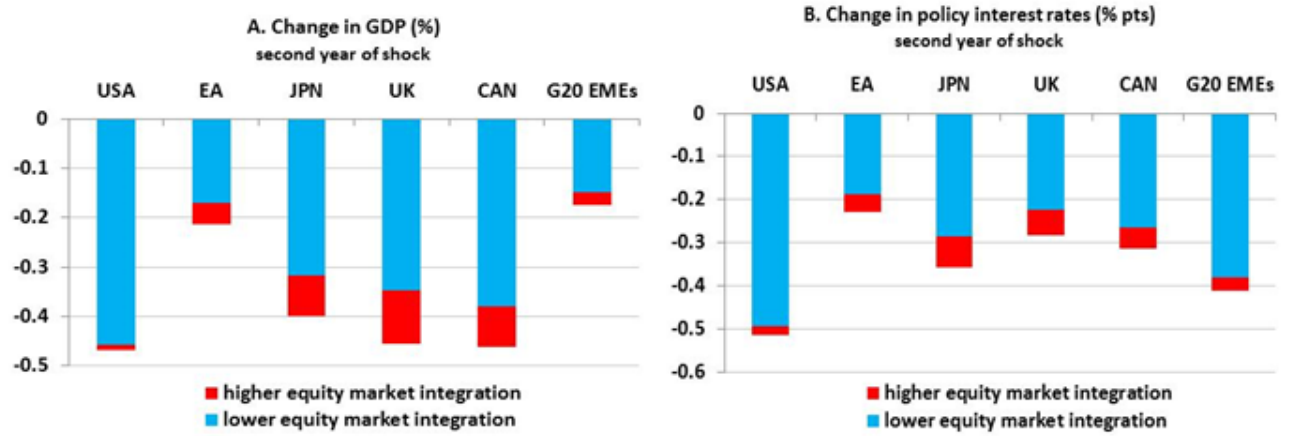
Two different scenarios are considered to reflect the change over time in the importance of global factors in the equity markets, as estimated in the OECD Economic Outlook 103. In a lower integration scenario, based on the strength of equity market linkages up to the mid-1990s, equity risk premia also rise by 60 basis points in the major advanced countries, and by 40 basis points elsewhere. In a higher integration scenario, reflecting the estimated strength of linkages over the past decade, equity risk premia rise by 80 basis points and 60 basis points, respectively.

GDP declines in all major economies in both scenarios, reflecting the impact of lower net wealth on household spending and the hit to investment from the higher cost of (equity) capital (Panel A in figure). The adverse effects are greater in the higher integration scenario, particularly in open economies where the importance of equity finance for investment is relatively high, such as Canada and the United Kingdom.

The impact of the shock and the cross-border spillovers would be larger still if they were not cushioned by monetary policy

easing. Since, in NiGEM, central banks react to the deviation of inflation and nominal GDP from their target levels, the fall in GDP leads them to cut policy interest rates by around ¼ percentage point in the major advanced economies by the second year, and by around ½ percentage point in the United States (Panel B in figure).

Spillovers from a rise in the US equity risk premium



Notes: Based on a rise of 1 percentage point in the US equity price risk premia for two years. The scenario with lower equity market integration is based on estimated linkages between global markets over 1984-95, and the scenario with higher equity market integration on estimated linkages over the past decade. Policy interest rates are endogenous in all areas. All shocks begin in 2018. The G20 emerging market economies are weighted together using PPPs.

Source: OECD calculations

Statlink http://dx.doi.org/10.1787/888933729439

In practice, there could be challenges for monetary policy if this type of shock, or a larger one, were to occur at a time when policy interest rates are very low. If monetary policy did not respond to the shock at all, the fall in GDP would be steeper by between one-quarter and one half relative to the case where shocks are cushioned by monetary easing.

Increased financial integration brings benefits including more efficient resource allocation, but it also strengthens cross-border shock transmission channels. This exposes countries to greater harm from negative shocks abroad increasing the need for stronger monetary and fiscal buffers.

[1] Allowing for flexible exchange rates would soften the effect of the shock on GDP over the short term in all countries but increase its persistence in most G20 emerging markets.

Reference:

OECD (2018), OECD Economic Outlook, Volume 2018 Issue 1, OECD Publishing, Paris.

The global impact of weaker demand growth in China

Category: China,Economic outlook,trade,Uncategorized
written by oecdecoscope | September 17, 2018
by Nigel Pain and Elena Rusticelli,

Greater international integration has modified the transmission channels and the impact that external shocks have on domestic economies via increased trade openness and exposure to global financial developments. One important change, discussed in the special chapter of the latest OECD Economic Outlook, is that growth prospects in OECD economies have become more sensitive to macroeconomic shocks in non-OECD countries. This reflects the rising share of the emerging market economies (EMEs) in global trade and finance. EMEs now account for one-fifth of world trade, up from around one-tenth two decades ago.

Changes in trade patterns and also in the intensity of trade (trade openness) have implications for the strength of the spillovers from any shocks in the EMEs. One particular example – the size of spillovers from a negative demand shock in China – is discussed below, using simulations on the global macroeconomic model NiGEM. The scenario considered is a 2-percentage point decline in Chinese domestic demand growth that persists for two years.

The trade-related spillovers from this shock are considered using versions of the model with different sets of trade patterns and different levels of trade openness (the share of trade in GDP).

- In a first scenario, the shock is simulated at a single point in time with two different sets of bilateral trade linkages in the model – the linkages that existed in 1995 and those that existed in 2016. The share of China in total global trade rose by close to 8 percentage points between these years.
- In a second scenario, the shock is simulated using a single set of bilateral trade linkages – those for 2016 – but with the shock occurring at two different starting periods with very different levels of trade openness. On average across economies, trade openness is 11 percentage points higher in the second starting point for the shock than in the first. This change is broadly comparable to the rise in trade openness in the decade or so prior to the financial crisis.

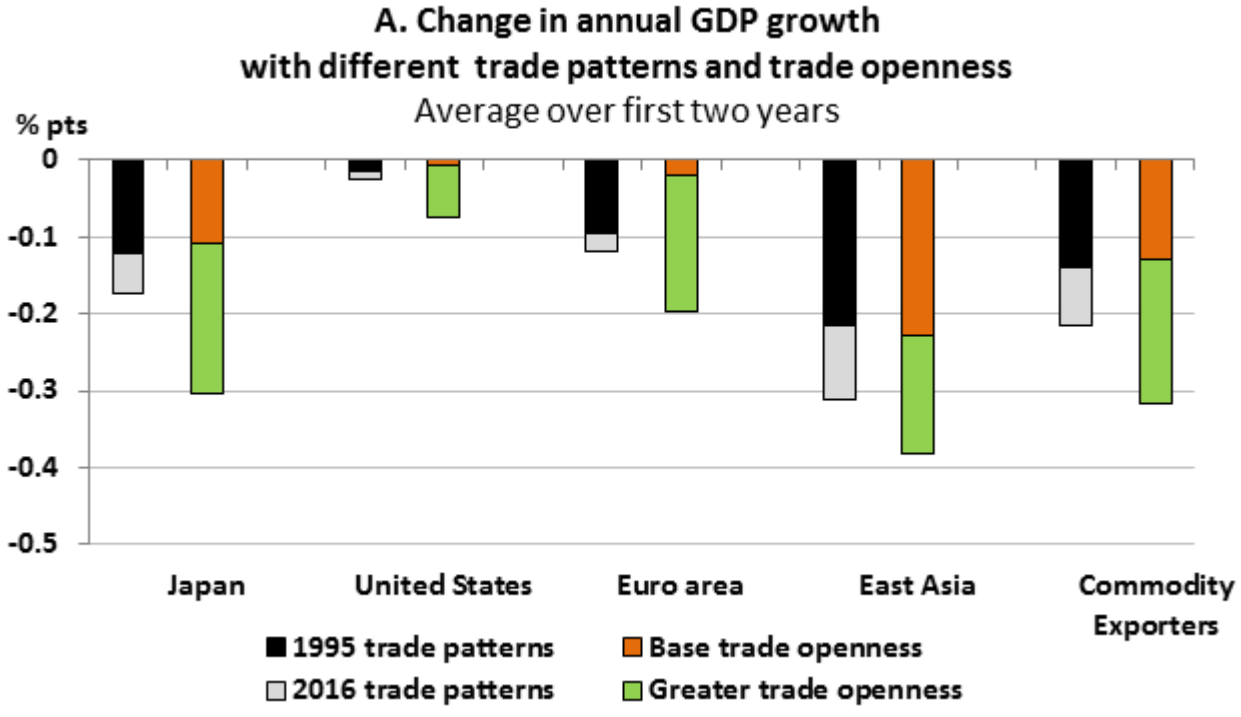
The adverse effects of the China shock on GDP growth in other countries increase as China becomes more integrated into global markets and as each country becomes more open to trade (figure below). In the scenarios considered, negative spillovers increase by more when trade openness is changed than from the stronger role of China in global trade, thus indicating that the general rise in cross-border trade over recent history contributes more extensively to changing transmission of shocks than the increase in the weight of single countries. GDP growth in most major OECD economies is reduced modestly, by 0.1-0.2 percentage points per annum, with a stronger impact in Japan. Negative output spillovers are larger in open economies more exposed to China via tighter GVC linkages, such as East Asia or commodity exporters.

GDP growth in China declines by between 1¼-1½ per cent per annum, depending on the particular scenario considered, with

import demand falling sharply. In the scenario with the higher level of trade openness, world trade growth declines by 1 percentage point per annum relative to baseline. At the same time, the slowdown in China puts downward pressure on export prices and import prices decline in all trade partners, partially helping to correct negative growth spillovers. Such effects become more important as the share of trade with China increases, and as economies become more open to trade.

The negative output spillovers would be larger still if monetary policy did not react, or was unable to react, to offset the adverse demand shock. Central Banks, targeting the deviation of inflation and nominal GDP from their target levels, cut policy interest rates, which by the second year of the shock decline by 25-50 basis points on average in the OECD countries (depending on the scenario considered) and by more in the economies most heavily exposed to China.

Heightened financial market uncertainty and weaker commodity prices could intensify the adverse impact of a demand shock in China over and above the direct trade-related impact considered here (OECD, 2015).



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A sustainable European currency needs a common fiscal stabilisation instrument

Category: Euro Area,European Union,fiscal policy,Uncategorized
written by oecdecoscope | September 17, 2018

Jan Stráský and Guillaume Claveres, OECD Economics Department, Euro Area/EU desk

The euro area sovereign debt crisis has exposed important flaws in the design of the Economic and Monetary Union, especially when it comes to dealing with macroeconomic shocks. Compared to federal states, fiscal transfers at the euro area and EU level are virtually non-existent. Since labour mobility remains low, private risk sharing in the euro area mainly takes place through cross-border flows of capital and credit, which may not always be sufficient to deal with large negative shocks.

The lack of effective risk-sharing is particularly damaging in a monetary union, where countries cannot use independent monetary policy or exchange rate depreciation to support growth and employment and national fiscal policies in some

countries may be unable, in the short run, to deal with country-specific shocks through national counter-cyclical policies. Moreover, monetary policy may become overburdened even when dealing with common shocks. During the financial crisis, contagion effects and negative feedback loops between sovereigns and banks threatened price stability and forced the ECB to reduce policy interest rates to below zero, coming probably close to an effective constraint for monetary policy. Even though the ECB put in place other unconventional measures, such as asset purchases, to ensure transmission of its policy, these measures are not without costs and limits.

The weak potential growth and inflation outlook for the euro area, as well as the global shifts in saving and investment preferences, also suggest that nominal interest rates may stay close to zero for a prolonged period of time and return close to zero more often in the future (Rachel and Smith, 2017).

In this situation, where the ECB monetary policy may remain constrained for some time and fiscal space limited in some countries, a common fiscal stabilisation instrument would improve the policy toolkit. Our recent paper, **Euro area unemployment insurance at the time of zero nominal interest rates** simulating a general equilibrium model of the euro area with imperfect risk-sharing mechanisms shows that a fiscal capacity, in the form of a common unemployment benefit scheme, can significantly improve macroeconomic stabilisation when the monetary policy constraints become binding.

Building a common fiscal stabilisation instrument for the euro area is an important topic of the 2018 Economic Survey of the Euro Area. The concept of a common fiscal instrument goes back at least to the 1970s Marjolin's Report and the interest in the topic has been rekindled post-crisis by several concrete proposals, including the IMF's rainy-day fund (Arnold et al., 2018), the European Commission's investment protection scheme (European Commission, 2017) and several variants of unemployment insurance and re-insurance schemes (Beblavý and

Lenaerts, 2017; Dullien et al., 2018). However, such schemes face significant resistance, due to the fears of permanent transfers towards some countries that would reduce incentives to carry out structural reforms. To overcome these criticisms, the scheme must avoid permanent transfers among countries, a condition made explicit in the Five President's Report.

Our companion paper, **Stabilising the euro area through an unemployment benefits re-insurance scheme,** discusses a novel design for a common fiscal stabilisation instrument, in the form of an unemployment benefits re-insurance scheme. As other recently proposed mechanisms (European Commission, 2017), the scheme is activated according only when unemployment increase and is above its long-term average, and involves a cap in payments, ensuring that pay-outs to individual countries are limited. These features, together with a mechanism charging higher contributions to countries that draw more frequently on the fund (experience rating), effectively prevent permanent transfers in the medium term.

Using counterfactual simulations of the proposed mechanism for individual euro area countries on annual data from 2000 to 2016, we show that the scheme would have delivered considerable stabilisation gains, both at the individual country level and euro area level (Figure 1). Macroeconomic stabilisation would be timely in most cases and achieved at the cost of limited debt issuance (less than 2% of the euro area GDP) and average annual contributions not exceeding 0.17% of GDP (Figure 2). It would have also avoided permanent transfers among countries, as none of them would have been a major net contributor or receiver with respect to the scheme, and all countries would have benefited from the scheme at one point in time.

Figure 1. The scheme could deliver significant stabilisation for the euro area

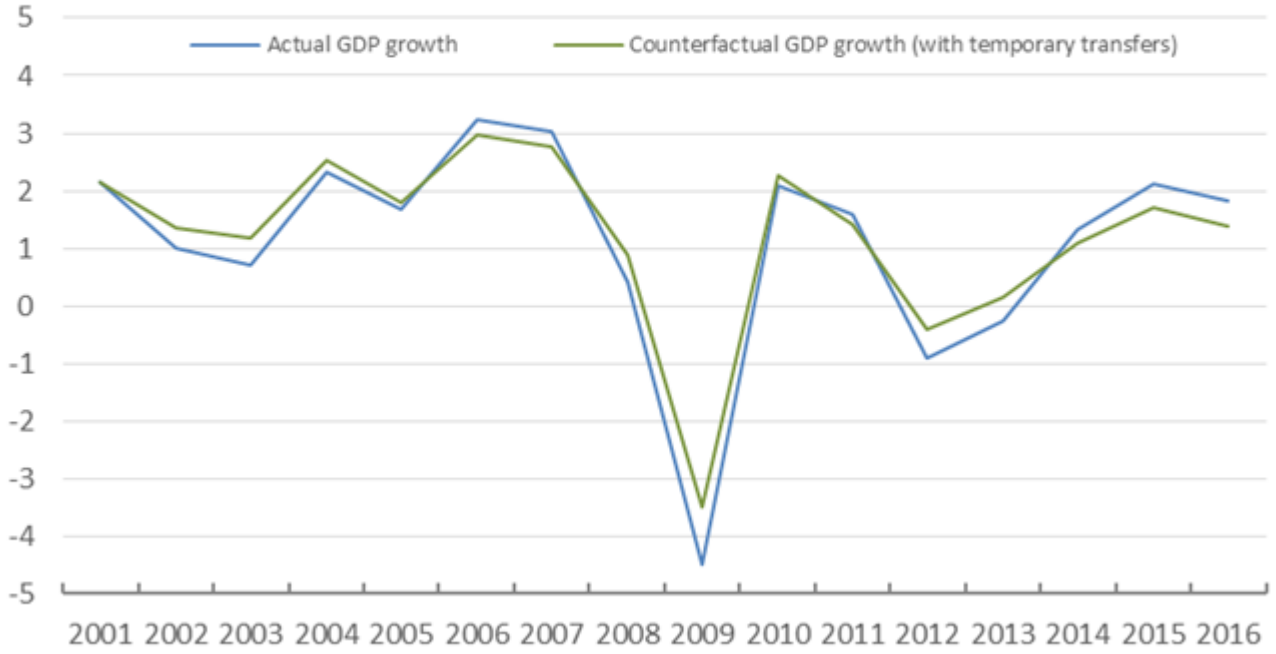
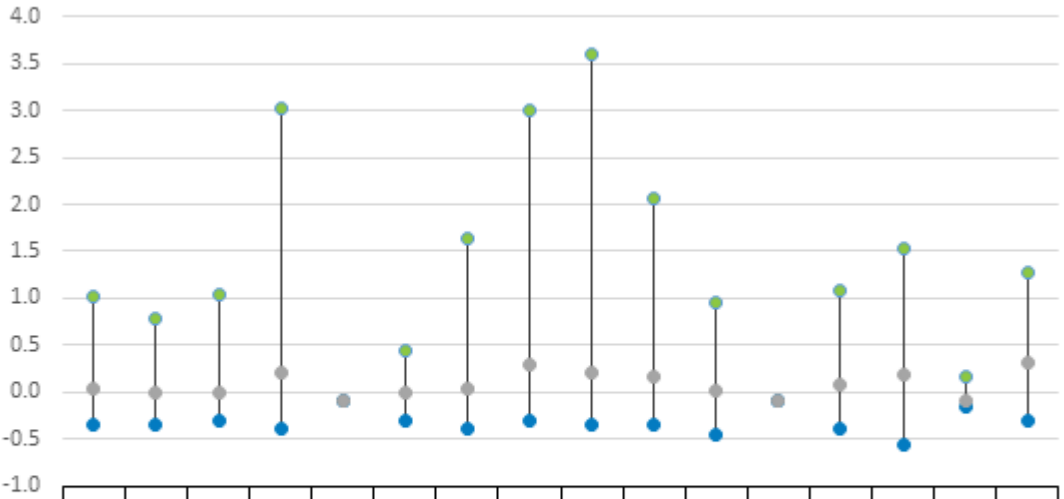


Figure 2. Pay-outs can be significant at times, but the average net transfers are close to zero

As a percentage of GDP



	AUT	BEL	DEU	ESP	EST	FIN	FRA	GRC	IRL	ITA	LUX	LVA	NLD	PRT	SVK	SVN
Maximum	1.01	0.79	1.04	3.02	-0.10	0.45	1.64	3.00	3.60	2.07	0.96	-0.10	1.08	1.53	0.17	1.27
Minimum	-0.35	-0.35	-0.30	-0.40	-0.10	-0.30	-0.40	-0.30	-0.35	-0.35	-0.45	-0.10	-0.40	-0.55	-0.15	-0.30
Average	0.04	-0.01	0.00	0.20	-0.10	0.00	0.04	0.28	0.21	0.16	0.02	-0.10	0.09	0.19	-0.09	0.32

Source: Claveres and Stráský (2018).

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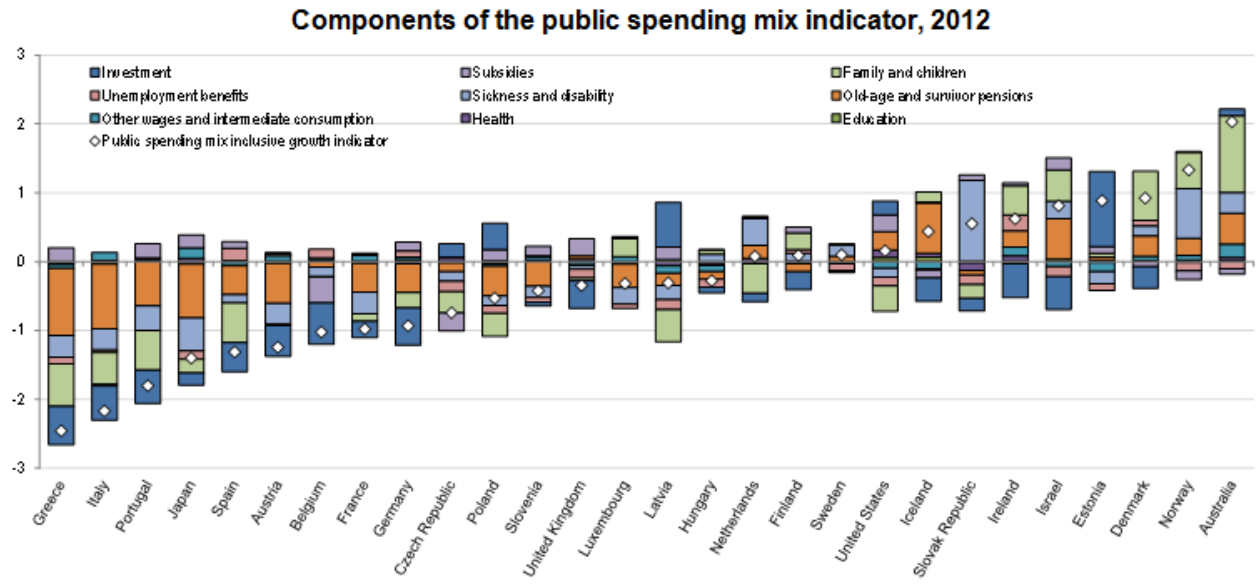
Does public spending foster inclusive growth in your country?

Category: Public finance,Uncategorized
written by oecdecoscope | September 17, 2018
by Debbie Bloch, Public Economics Division, Economics Department

Governments today need to balance the policy goals of boosting economic growth and improving equity when making budget decisions. How can public spending choices promote inclusive growth? What can be learned from previous spending decisions in times of crisis?

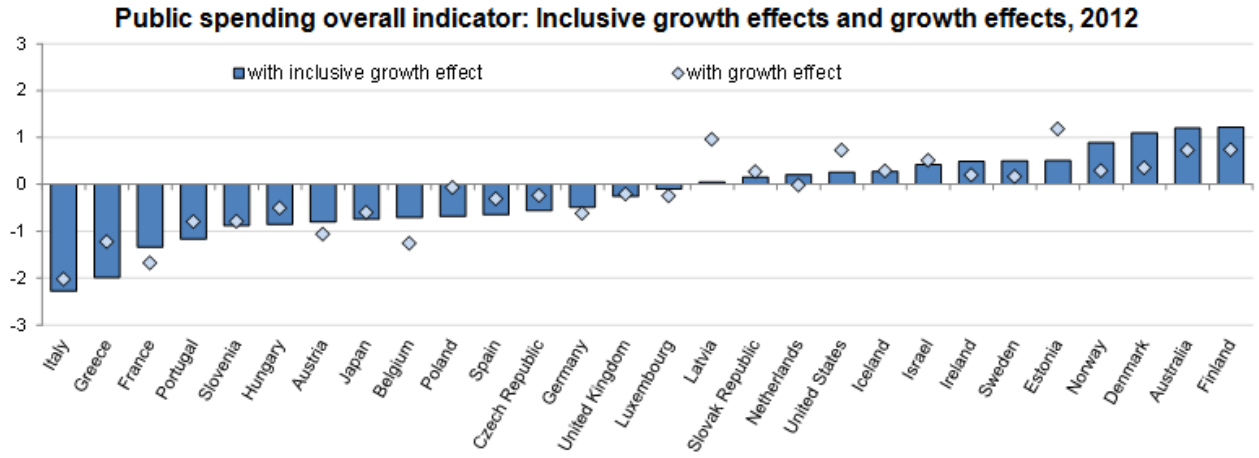
As it becomes increasingly important for policymakers to look at public finances in terms of both growth and income equality, a new set of indicators has been developed to help governments assess how public spending can be geared toward achieving these twin goals.

A first set of indicators combines information on the mix of public spending. Each spending item share is multiplied with an estimated coefficient from growth and inequality equations to build both a growth and an income distribution component, which is then summed up to an aggregate inclusive growth indicator. The outcomes show that public investment and family and child benefits help butress inclusive growth, while old age pensions and government subsidies hurt the most. The indicator below shows that the public spending mix is least conducive to inclusive growth in Greece and most conducive in Australia.



Source: Bloch, D. and J. Fournier (2018), "The Deterioration of the Public Spending Mix during the Global Financial Crisis: Insights from New Indicators", OECD Economics Department Working Papers, No. 1465, OECD Publishing, Paris, https://doi.org/10.1787/2f6d2e8f-en

Taking the analysis further, a second set of indicators adds information on the size and effectiveness of governments to the public spending mix analysis, providing an overall indicator on the effects of public spending on inclusive growth. This indicator shows that countries with large but efficient governments, such as Nordic countries, along with those favouring inclusive-growth friendly spending items do well in the indicator ranking, while those with less-effective governments, and with high old-age pension spending tend to do worse.



Source: Bloch, D. and J. Fournier (2018), "The Deterioration of the Public Spending Mix during the Global Financial Crisis: Insights from New Indicators", OECD Economics Department Working Papers, No. 1465, OECD Publishing, Paris, https://doi.org/10.1787/2f6d2e8f-en

Policymakers need to be aware of these effects when facing hard choices, particularly during times of economic crisis. Analysis based on these new indicators have shown there is a striking link between the growth component of the public spending mix indicator and the output gap: the capacity of the public finances to support inclusive growth deteriorated markedly in the countries hardest hit during the recent crisis, as governments slashed budgets with little regard to which items would underpin inclusive growth.

What can we take away from this? Countries facing pressure to reduce spending during an economic downturn need to consider which spending items would be most – and least – condusive to inclusive growth, to ultimately help them come out stronger after a crisis. Increasing public investment and family benefits, for example, while targetting reductions in less productive spending items should help assure healthier, fairer economies.

Reference:

Bloch, D. and J. Fournier (2018), "The Deterioration of the Public Spending Mix during the Global Financial Crisis: Insights from New Indicators", *OECD Economics Department Working Papers*, No. 1465, OECD Publishing, Paris, https://doi.org/10.1787/2f6d2e8f-en.

Further reading:

Fournier, J. and Å. Johansson (2016), "The Effect of the Size and the Mix of Public Spending on Growth and Inequality", *OECD Economics Department Working Papers*, No. 1344, OECD Publishing, Paris, https://doi.org/10.1787/f99f6b36-en.

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Delivering on the promise of better outcomes for Canadian women

Category: Canada,Gender,Labour markets,Uncategorized
written by oecdecoscope | September 17, 2018
by Andrew Barker, Canada Desk, OECD Economics Department

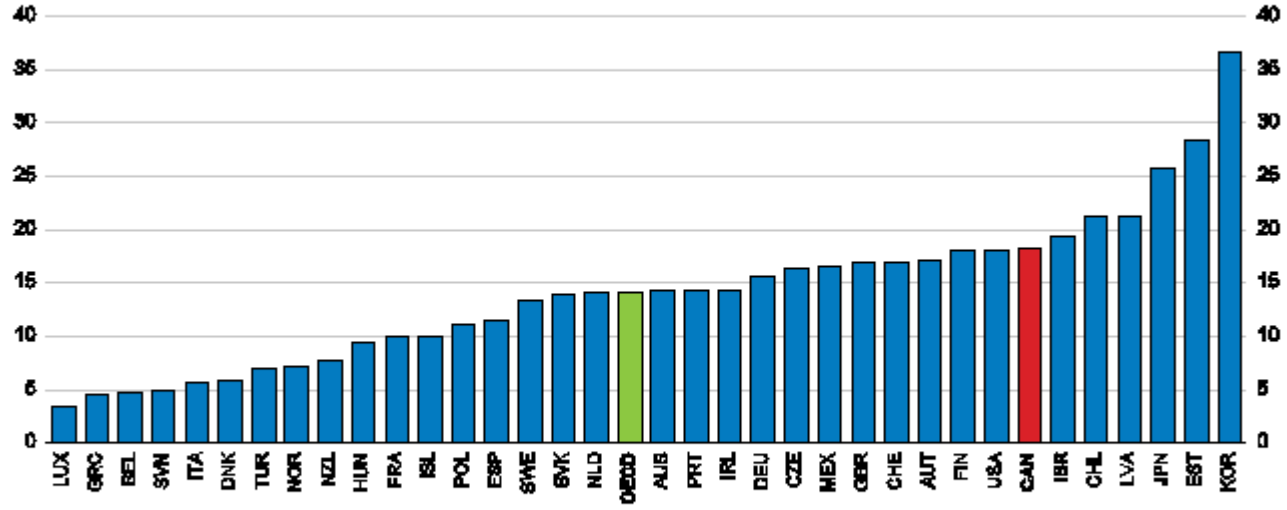
The current Canadian government has declared itself feminist and has taken a number of steps to improve labour market outcomes for women. This includes increased funding for early learning and child care and improving equality of parental leave by introducing five weeks of leave for the second parent (generally fathers) on a take it or lose it basis. In terms of employment and labour force participation, Canadian women do

much better than the OECD average.

However, there remains a sizeable gap in earnings between Canadian men and women (Figure 1).

Figure 1. The gender earnings gap is above average in Canada

2016 or latest year available[1]



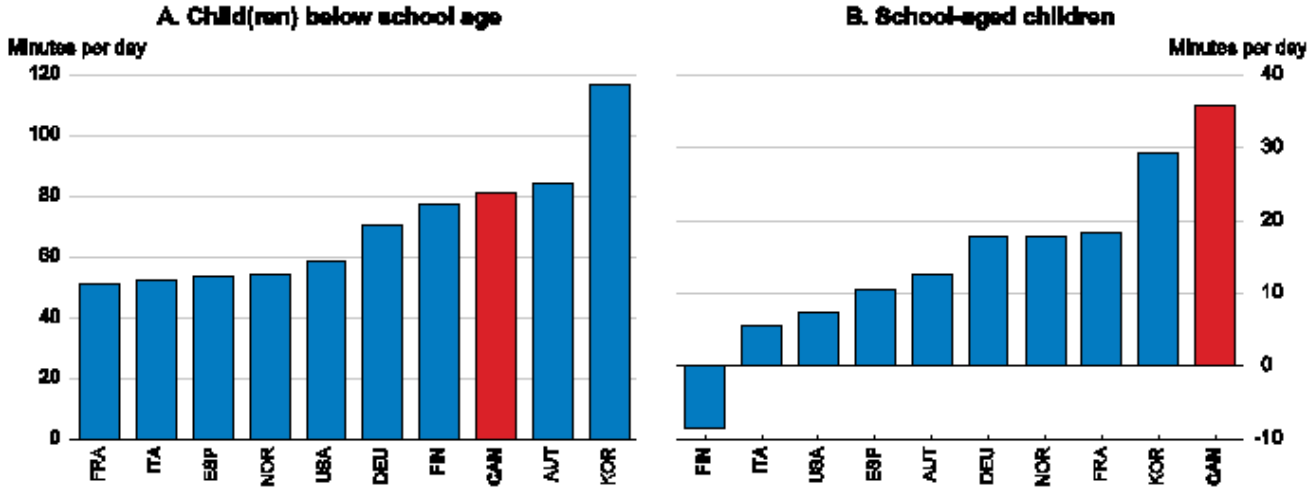
1. The gender wage gap is defined as the difference between median earnings of men and women relative to median earnings of men. Data refer to full-time employees and to self-employed. For Canada data are based on weekly earnings.

Source: OECD (2018), *Gender Database*, https://data.oecd.org/earnwage/gender-wage-gap.htm.

The earnings gap is particularly large for women with children, in part explained by fewer years of work experience and more hours devoted to unpaid work (Figure 2). This might be fine if it was the result of personal choices on how to split paid and unpaid work between couples, but international survey evidence indicates that women would like to work more and, within Canada, comparison with Quebec – where women have for many years enjoyed affordable child care and more equitable division of parental leave – indicates that Canadian women would choose to work more if given access to more family-friendly policy support.

Figure 2. Canadian fathers spend less time on childcare activities than mothers[1]

Time spent on childcare activities by women less time spent by men, by youngest child's age



1. Data for partnered men and women (those who live in the same household as a spouse or cohabitating partner, married or not) in couples with a female partner aged 25-45, only. Pensioners and students excluded. Data restricted to 'carers', i.e., mothers and fathers who are engaged in at least one childcare activity during a time-use diary day.

Source: OECD (2017), *The Pursuit of Gender Equality: An Uphill Battle*, Figure 15.2.

An important step in this regard is to make sure that new fathers use the additional leave that they are now entitled to. Governments need to work with businesses and lead by example to create a culture where men are encouraged to take leave to look after their young children. Payment rates for parental leave may need to be adjusted if take-up remains low, as it has in some other OECD countries with low payment rates.

Improving access to high-quality, affordable early childhood education and care (ECEC) is the best way to improve labour market outcomes for Canadian women. Canada stands out among OECD countries for the high cost of childcare (in the comparison province of Ontario, at least) and the low share of Canadian youth who have attended ECEC for two years or more. Affordable and high quality ECEC can address barriers to mothers' labour force participation, reduce the motherhood wage penalty and support child development, particularly for disadvantaged children. While there are upfront fiscal costs, these are offset over a longer period through women's higher participation and productivity. Women's productivity, and thus incomes, would also be assisted by further steps to promote

female entrepreneurship and to boost women’s representation in senior management, computing and engineering.

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