

# Does decentralisation foster regional GDP convergence?

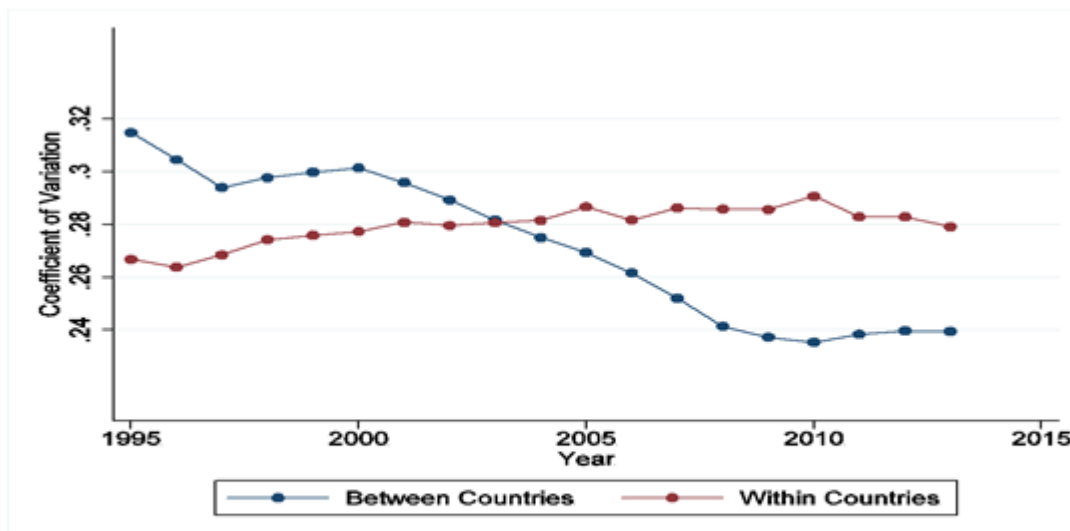
Category: fiscal policy, Inequality, Uncategorized

written by oecdecoscope | September 23, 2016

by Hansjörg Blöchliger, Senior Economist, Policy Studies Branch, Economics Department

The growth pattern of OECD countries and their sub-national entities is puzzling. Between-country differences in GDP per capita are declining, yet the differences across jurisdictions within those countries tend to rise. Put in other words, countries' GDP converges, while the output of their sub-national jurisdictions tends to diverge (Figure 1). Today differences across countries are smaller than, on average, within a country, which is quite different from the situation 20 years ago.

Figure 1. Inequality is decreasing between but increasing within countries



Note: The indicator *Within Countries* is the coefficient of variation of regional GDP per capita within each country, averaged over the OECD countries available in the sample; the indicator *Between Countries* is the coefficient of variation of national GDP per capita between those countries. The coefficient of variation is a measure for disparities in GDP per capita. The sample covers 26 OECD countries.

Source: Calculations based on data from OECD National Accounts and OECD Regional Database.

What could explain the puzzle? Agglomeration economies and the unequal geographical impact of globalisation could play a role. Trade and other forms of international exchange are

dominated by firms that tend to be located in large agglomerations. Convergence of countries could hence be driven by the convergence of agglomerations that are well-integrated into global value chains. The picture looks different if one looks at a single country. When productivity is underpinned by agglomeration forces, regions with large agglomerations will pull ahead of regions without, and differences in growth rates become self-propelling. As a result, countries converge while regions diverge. Indeed, decomposing GDP suggests that differences in sub-national productivity are the main driver of GDP per capita disparities.

Yet rising GDP disparities are no fate. They depend on a country's intergovernmental framework and can be tackled by policy. Assigning more fiscal power to the sub-national level – e.g. for spending on education or infrastructure – can contribute to a more balanced development across a country. According to new OECD research, GDP disparities tend to be smaller in more fiscally decentralised countries, and tend to grow more slowly or even to decline there. The type of fiscal decentralisation matters: Assigning more taxing power to the sub-national level underpins convergence, while a large intergovernmental transfer system has the opposite effect. Interestingly, catching-up regions tend to benefit more from decentralisation than the frontier regions. They appear to adopt policy innovations more rapidly and those seem to have a stronger impact. Conversely, intergovernmental grants tend to fuel disparities, probably because they do not provide lagging regions with the right incentives to catch up. The channel from decentralisation to convergence has yet to be investigated; i.e. whether productivity trickles down faster or whether capital and labour moves more swiftly across jurisdictional borders.

### **Further reading:**

Blöchliger, H., D. Bartolini and S. Stossberg (2016), "Does Fiscal Decentralisation Foster Regional Convergence?", *OECD*

# Achieving and sharing the benefits of globalisation

Category: trade, Uncategorized

written by oecdecoscope | September 23, 2016

by Catherine L. Mann, OECD Chief Economist, and Ken Ash, Director of the OECD Trade and Agriculture Directorate. This post was also published by the OECD Insights blog

Yesterday's OECD Interim Economic Outlook warns that trade growth is slowing, contributing to another slowing of global GDP growth in 2016 and with few signs of improvement for 2017. Does it really matter? If we believe the current anti-trade, anti-globalisation rhetoric, we might shrug our shoulders and say "no". Trade has been so maligned and demonised, some might even be pleased.

But that would be the wrong answer. Open trade and cross-border investment are key vectors for diffusion of new technologies and competition, which are central to achieving productivity gains and improving well-being. New research published yesterday by the OECD in conjunction with the Interim Economic Outlook suggests that a substantial part of the post-crisis slowdown in total factor productivity growth could be reversed if trade intensity were to recover. In short, weak trade is one of the factors that will keep the economy in a "low-growth" trap where sluggish trade and investment lead to diminished growth expectations and rising financial risks.

Over decades, trade has been responsible for drawing hundreds of millions of people out of poverty – and we mean one and two-dollar-a-day poverty – in emerging and developing countries. Trade could perform this same miracle for the many millions still living in abject poverty in poor countries in Asia and Africa, if other conditions are also right of course. Salaries and working conditions are almost always better in companies that trade than in those that do not, and this is true in countries at all levels of development. Households gain hugely from trade because it increases choice and reduces prices.

The prospects of millions of workers in the global economy depend on their participation in global value chains, as highlighted by statistics developed by the OECD with the WTO on Trade in Value-Added (TiVA). The main insight from these data is first, in order to export efficiently, a company has to also import efficiently. A second key insight is the importance of high quality services to support trade and trade-intensive activities. It should be of great concern that there are signs that the development of global value chains appears to have gone into reverse in recent years.

The OECD paper looks at the reasons for the trade slowdown and back-tracking in the development of global value chains. Several factors are at play, some of them cyclical in nature, others structural like the changing role of China in the global economy. Increasingly murky protectionism is contributing to the slowdown, as is the failure to implement any really ground-breaking global new trade initiatives for more than a decade. Without entering into a rather futile debate about when the slowdown really started or the exact contribution of structural versus cyclical drivers, let us instead ask what governments can do to reverse it.

The *OECD Interim Economic Outlook* calls for implementation of a package of measures to boost demand, including through

collective fiscal action focused on raising investment and productive spending, and structural reforms. Removing barriers to trade and creating the conditions for people to reap the potential benefits of trade should be at the heart of the structural reform agenda.

First, governments should put their weight behind efforts to further lower trade barriers and unnecessary trade costs by implementing the Trade Facilitation Agreement, vigorously pursuing the reduction of restrictions on services trade, including by concluding the trade in Services Agreement (TISA), co-operating to reduce costly and unnecessary regulatory differences, concluding the Agreement on Environmental Goods, and by coming to the table to deliver a good result at the 11th WTO Ministerial Conference a little over a year from now. They should reduce remaining barriers to foreign direct investment. There are unilateral, bilateral, plurilateral and multilateral channels available if governments want to provide those growth opportunities that are currently lacking.

Second, governments need to step in to ensure that the benefits of trade are fairly shared. Governments should help those affected by the churn and disruption caused by globalisation. Benefits from trade are diffuse and long-term in nature. Losses tend to be sharp and very concentrated on individuals and regions. The people most affected are sometimes those with the least capacity to adjust. An unemployed steel worker does not take much comfort from knowing that programmers in Silicon Valley are thriving, or that T-shirts and smartphones are cheaper. What he or she needs is a decent job, new training and skills, and a robust social safety net to help through the transition.

Making trade work better for more people is not just about persuading them, although clearer and more honest communication is important. It is about ensuring that the full panoply of structural policies is put to work to ensure that

people are able to reap the benefits that more open trade, technology, and investment will bring. This means paying attention to infrastructure, well-functioning financial markets, education and skills, clear and transparent institutions and rule of law – all the things that make an economy nimble. Trade policy cannot be made in a vacuum but rather must be part of the fabric of domestic policies. If we are not able to do this, growing public scepticism, particularly in the most advanced economies, may mean that further market opening will be difficult, if not impossible. Such a result would impoverish many across the world.

## References:

OECD Interim Economic Outlook, September 2016.

Haugh et al (2016), “Cardiac Arrest or Dizzy Spell: Why is World Trade So Weak and What Can Policy Do About It?” OECD Economic Policy Paper No. 18, September, OECD Publishing, Paris.

---

# Global growth warning: weak trade, financial distortions

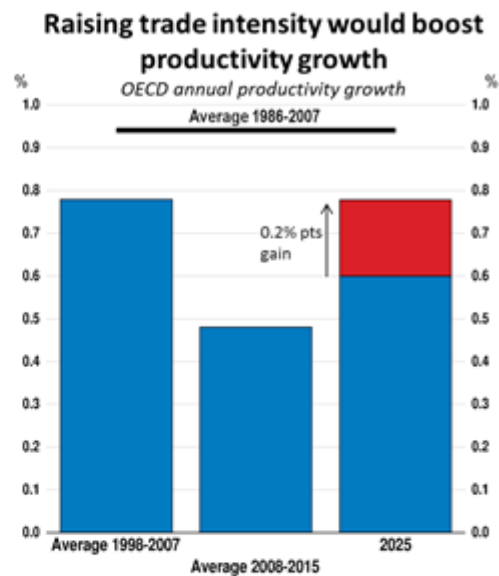
Category: Economic outlook, Euro Area, finance, trade, Uncategorized  
written by oecdecoscope | September 23, 2016  
By Catherine L. Mann, OECD Chief Economist

The global economy remains in a low-growth trap. In our latest *Interim Economic Outlook* global GDP growth is set to remain flat around 3% in 2016 and improve modestly to 3.2% in 2017. This is slightly lower than the June *Economic Outlook*

forecast due to weaker conditions in advanced economies, including the effects of Brexit, offset by a gradual improvement in major emerging market commodity producers. More significantly, this string of feeble global growth rates is well-below historical norms.

The prolonged weakness in the world economy generates a self-reinforcing low-growth trap: depressed trade, investment, productivity, and wages in the current weak global environment, in turn lead to an additional downward revision in growth expectations and even more subdued demand. Poor growth outcomes combined with high inequality and stagnant incomes are also further complicating the political environment and increasing challenges facing policymakers.

Weak global trade is a particular concern. World trade was growing exceptionally slowly after the financial crisis, and has collapsed in 2015 and 2016. This weak trade growth is both a symptom of and exacerbates the weak global environment. As I have written separately, trade matters for productivity, living standards and inclusive growth. Returning to robust trade growth requires policy action to deepen global integration, but even more importantly to share the benefits, as detailed in our new paper examining the trade slowdown and policies to boost trade.



Note: The left-hand-side structural real time global value chain indicator is adjusted for the economic cycle and changes in commodity prices. The right-hand-side presents a scenario in which the world and OECD trade intensity (exports plus imports as a share of GDP) increases by 1.3 percentage points per annum (the average from 1986-2007) from 2017. The effect of this increase on OECD total factor productivity growth is shown. For further detail see OECD Economic Policy Paper "Cardiac Arrest or Dizzy Spell: Why is World Trade So Weak and What Can Policy Do About It?"

Source: OECD Economic Outlook databases, OECD STAN Bilateral Trade database; Égert and Gal (2016); and OECD calculations.

Significant distortions in financial markets create vulnerabilities, made particularly stark against the poor performance of the real economy. Short- and long-term interest rates have fallen further in recent months to very low and – in many cases – negative levels. Around USD 14 trillion of government bonds, more than 35% of OECD government debt, is currently trading at negative yields, reflecting, among other factors, expectations for persistently low growth and expected monetary policy.

Low and negative interest rates underpin widespread and substantial increases in asset prices, both internationally and across asset classes. Equity prices remain high and have continued to increase in some economies despite weak profit developments and reduced long-term growth expectations. House prices are also rising rapidly in many economies. Credit spreads have tightened this year even as overall credit quality for corporate bonds has declined.

These financial distortions raise risks. In particular, a reassessment in financial markets of the path of interest rates could result in substantial re-pricing of assets and heightened financial volatility. As it is, sustained negative and low interest rates challenge financial institutions' business models and sustainability, demonstrated by the underperformance of bank shares relative to the overall market. Low interest rates also pose significant challenges for pension funds and asset managers, with implications for savers and retirement incomes.

Monetary policy is overburdened with associated risks. Hence, central bank policymakers need to calibrate both costs and benefits of increasing unconventional support.

On the other hand, fiscal space has been created by the low interest rates. In many advanced economies, interest rates have fallen by more than GDP growth, thereby raising the sustainable debt level. Low interest rates have reduced interest expenses. Hence, fiscal policy should take advantage of this fiscal space by increasing quality investment to boost human capital, physical infrastructure and equality. Canada, China, Japan and the US have recently announced fiscal expansion and the UK has signalled an easing in the budgetary stance. Euro area fiscal policy also should do more to support growth, such as easing the application of the EU Stability and Growth Pact and excluding net investment spending from fiscal rules.

Structural reform momentum needs to be intensified, rather than continue to slow. At the Hangzhou Summit earlier this month, G20 countries were only around half-way to their target of 2% additional G20 GDP by 2018 due to sluggish progress on implementation. Worryingly, despite concerns about weak trade, the share of trade policy commitments fell to 6% from 14% two years ago. Reforms to boost trade are a key lever to boost growth and need to be supported by complementary policies that ensure the gains from globalisation are widely shared among

citizens.

The more balanced policy mix, making greater use of fiscal, structural and trade policies, would put the global economy on a stronger and more sustainable and inclusive growth path. Improved expectations of higher future growth from more fully deployed fiscal and structural policies would help to ease the burden on monetary policy and facilitate an eventual normalisation of interest rates.

## **Bibliography**

OECD Interim Economic Outlook, September 2016.

Haugh et al (2016), "Cardiac Arrest or Dizzy Spell: Why is World Trade So Weak and What Can Policy Do About It?" OECD Economic Policy Paper No. 18, September, OECD Publishing, Paris.

---

# **Enhancing Greek exports is key to jobs and growth**

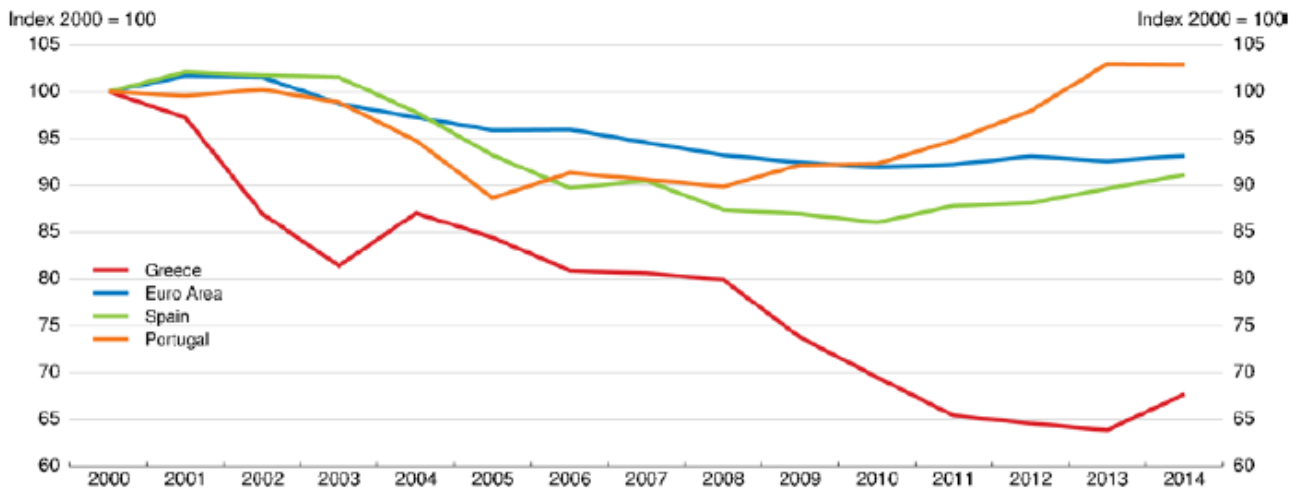
Category: Greece, Labour markets, trade, Uncategorized

written by oecdecoscope | September 23, 2016

By Christine de La Maisonnette, Economist on the Greek desk, Economics Department

With weak domestic demand and a relatively low export share in the economy there is much potential to raise exports. Despite a recent pick-up Greek export performance deteriorated in the last decade particularly in the service sector and by much more than in the Euro area on average (Figure 1).

Figure 1 Export performance<sup>1</sup> is slightly rebounding after declining since 2000

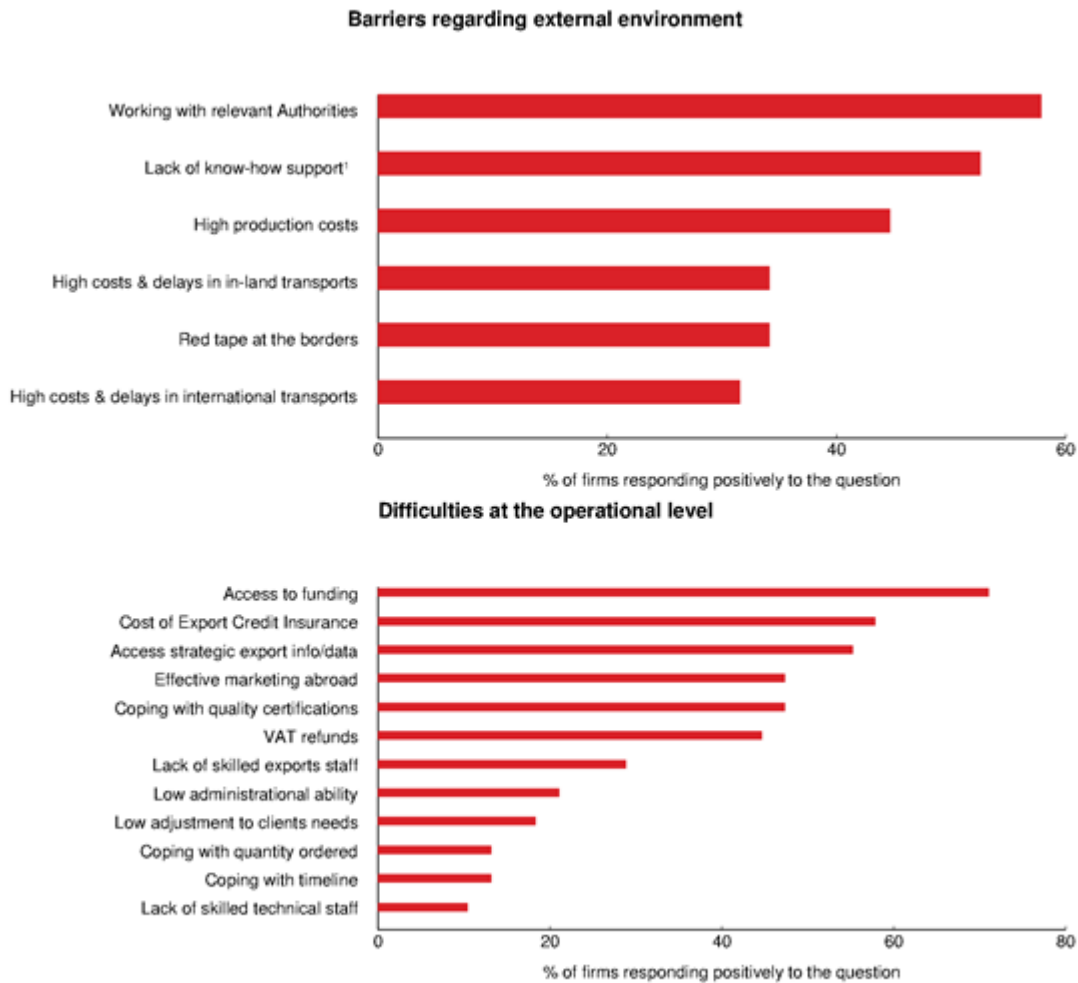


1. Export performance is calculated as the ratio of exports of goods and services to export market.

Source: OECD Economic Outlook 98 database.

The decline in unit labour costs since 2010 has restored cost competitiveness, but the response of exports has been sluggish due to severe liquidity constraints and lagged price adjustment. While some of the decline reflects drops in oil prices and world shipping demand, structural problems in product markets, barriers to exporting, access to finance and administrative burden affect competitiveness and export performance (Figure 2).

Figure 2. Barriers faced by exporting firms are still important



1. Chambers of Commerce, Commercial Attaches etc.

Source: Panhellenic Exporters Association.

Export performance is also affected by low integration in global value chains (GVCs). The small size of the manufacturing sector, low FDI flows, inefficient infrastructure and dominance of small and informal enterprises have contributed to a low technology content of goods exports and make integration difficult (Bank of Greece).

Competitiveness and exports can be boosted by policy reforms. Policies that create a business environment where firms can easily enter (and exit) the market and young high-performing firms can thrive and grow are particularly important. Increasing the efficiency of the judiciary system is important to improving the business environment as it reduces uncertainties and transaction costs. The implementation of a

'national single window' for exports, as foreseen by the National Trade Facilitation Strategy (NTFS) for Greece, would act as a one-stop shop, specifically for export procedures and is expected to significantly alleviate the high cost and long time periods involved in exports. This would help competitiveness. Liberalising further product markets and better bankruptcy procedures would also help SMEs grow.

Improving investment in human and knowledge-based capital would enhance integration in GVCs. This calls for more support to quality education and skills training. This will require improving the quality of teachers by linking teaching evaluation to effective professional development, making schools more autonomous and accountable and introducing a performance evaluation system for universities. Also innovation and investment in ICT would enable product differentiation and gains in market shares. For instance, only around 10% of Greek firms sell via e-commerce compared to 21% in OECD countries on average.

As many services particularly related to R&D, product design and development are inputs to export products, it is important to reduce inefficiencies in input markets. Further liberalisation in regulated professions such as engineers would boost high-technology goods exports. The quality of transport infrastructure could also be improved. The gap is particularly important for railroad and, albeit to a lesser extent, road infrastructure. Reforms have been put in place to enhance the weak transportation sector, but there is still considerable scope for developing port activities as a gateway to the land transportation network, not just for Greece but for the entire region. Boosting investment in logistics should continue. One way forward would be to make better use of public land through concessions or privatisations to facilitate investment in logistics and infrastructure.

## References

De la Maisonneuve, Christine (2016), How to Boost Export Performance in Greece, OECD Economics Department Working Paper no. 1299.

OECD (2016), Economic Surveys: Greece 2016, OECD Publishing, Paris.

OECD Economic Outlook 98 Database

---

# Pump-priming productivity through reform: the case of Lithuania

Category: Lithuania, Productivity, Uncategorized

written by oecdecoscope | September 23, 2016

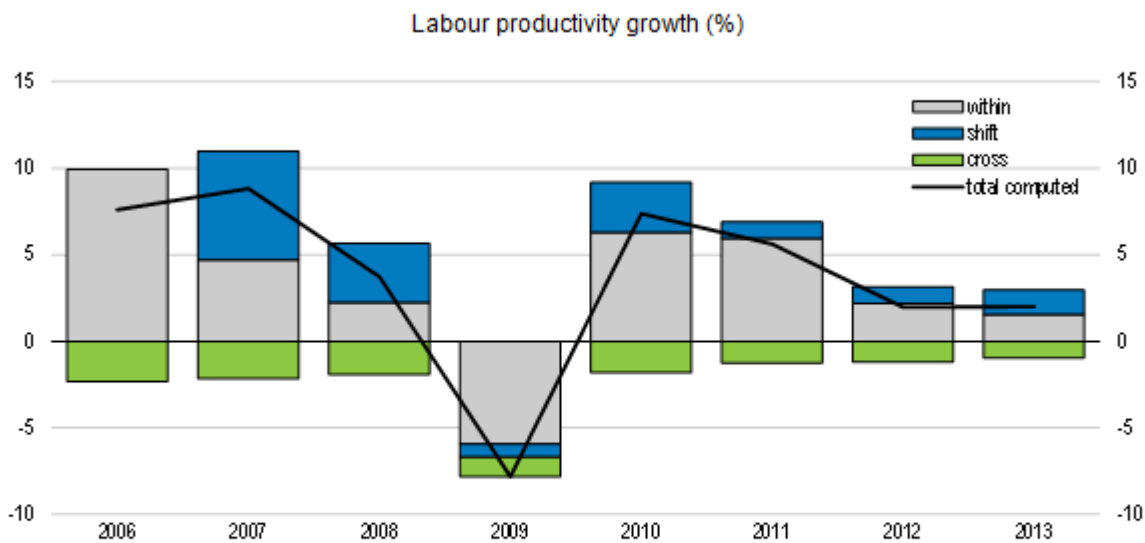
By Ben Westmore, Economist, Country Studies Branch, OECD Economics Department

In the past two decades, the income level in Lithuania has steadily risen toward that of OECD countries. Between 1995 and 2013, GDP per capita rose from one third to two thirds of the OECD average. Productivity catch-up was critical to this process, aided by enhanced integration into the global economy which enabled the adoption of more advanced production technologies from abroad.

Decomposing Lithuanian labour productivity growth in the 2006-2013 period reveals that both reallocation of resources between sectors and within-sector productivity growth have been important (Figure 1). The latter can be driven by

reallocation between firms in the same sector as well as increases in within-firm productivity.

Figure 1. Productivity has benefitted from both within-sector advances and between sector reallocation



Note: "Within" measures the contribution to total labour productivity growth from productivity growth within sectors. "Shift" measures the contribution resulting from the movement of labour between sectors. "Cross" indicates whether the within-sector and between-sector effects are complementary. A negative value for the latter indicates that productivity growth is particularly strong in sectors that have a contracting labour share.

Source: OECD calculations based on data from Statistics Lithuania.

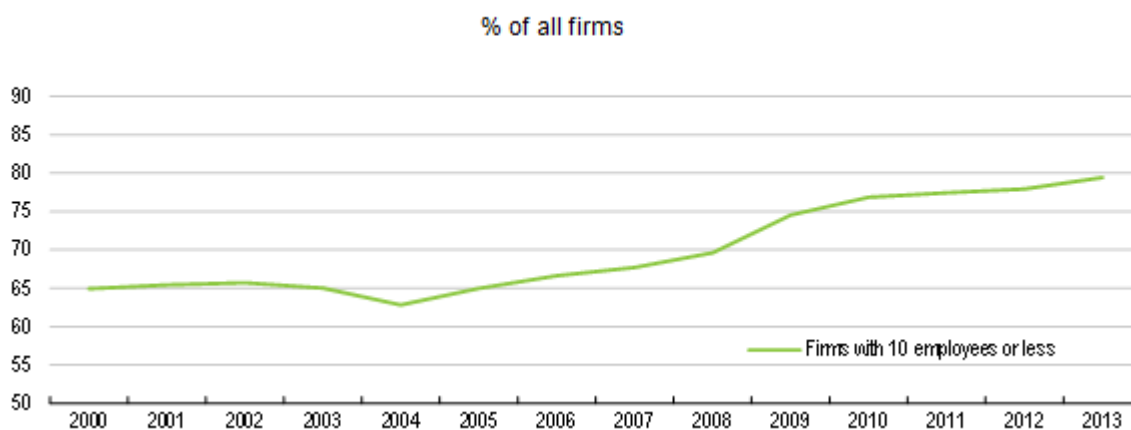
Compared with other countries, the contribution to productivity growth of between sector reallocation (i.e. the "shift" effect in Figure 1) has been large in Lithuania. This may reflect a series of reductions in regulatory barriers to firm entry over the past decade. According to the World Bank *Doing Business* indicators, the cost to start a business fell from 4% to 0.6% of income per capita between 2003 and 2015. Specific reforms included the establishment of a new form of legal company (a "small partnership") that has no minimum capital requirement and a reduced number of regulatory procedures. A one-stop shop for online business registration was also introduced as well as measures to reduce the difficulty of companies to register as a value added taxpayer.

Indeed, new OECD empirical analysis at the industry-level across the 2006-2013 period identifies that these policy changes have been associated with increased contributions to productivity growth through both the "within" and "shift" effect in Lithuania (see Chapter 1 of the Lithuania Economic

Assessment for details). One channel through which this likely arose is by such reforms enabling increased entry of young small firms that subsequently obtained market share at the expense of poorer-performing incumbents. This is consistent with the fact that the firm exit rate in Lithuania was around double the European Union average during the period.

The trends from firm-level data fit this interpretation. Firm-level estimates suggest that multifactor productivity growth in Lithuania would have been around one-third lower over the 2000-13 period without new firm entry. Accordingly, these data show a steep pick-up in the proportion of small businesses in Lithuania during the past decade (Figure 2).

Figure 2. Proportion of small firms



This is not to say that all the necessary reforms in Lithuania have been undertaken. The level of labour productivity is still around one-third below the OECD average. The education system at all levels can do a much better job at producing graduates with the skills required by firms, state-owned enterprises occupy a relatively large share of the economy (and many of these underperform) and innovation in the business sector is low. However, Lithuania's recent record of productivity-enhancing product market reforms gives reason for optimism that policymakers can make the policy adjustments needed to further promote convergence and the living standards of the population.

Find out more:

Lithuania productivity country profile

OECD (2016), *Economic Survey: Economic Assessment of Lithuania 2016*, OECD Publishing, Paris.

OECD (2016), *Review of School Resources: Lithuania*, OECD Publishing, Paris.

OECD (2015), *Regulatory Policy in Lithuania*, OECD Publishing, Paris.

OECD (2015), *Review of Lithuania's Position Relative to the OECD Guidelines on Corporate Governance of State-owned Enterprises*, OECD Publishing, Paris.

---

# When size matters: scaling up delivery of Czech local services

Category: Czech Republic, Uncategorized

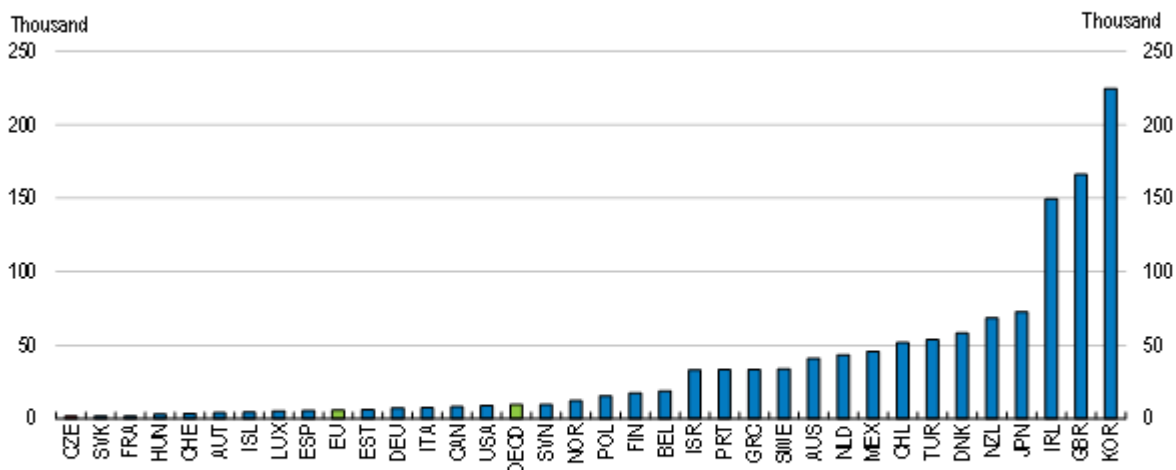
written by oecdecoscope | September 23, 2016

By Christine Lewis, Economist, Country Studies, OECD Economics Department

A key argument for small local governments is that they can better deliver the services that their residents want and need. A key question is: what size is too small? When is the average cost of services too high, the range of choice too narrow or expertise spread too thinly across the country? These questions are especially relevant in the Czech Republic

where there are over 6 200 municipalities – the smallest on average in the OECD (Figure 1). Almost one-quarter of municipalities have less than 200 residents; around three-quarters have less than 1 000 residents.

**Figure 1: Czech municipalities are the smallest in the OECD**  
Average number of residents



Note: Average calculations are based on estimated population data as of 2015 or 2016 for most countries. Data for OECD and EU are unweighted averages.

Source: OECD (2016), [Subnational Governments in OECD Countries: Key Data](#) (brochure), OECD, Paris.

Municipalities have important responsibilities in delivering key services including education, healthcare, transport, public housing and waste removal. It seems that scaling up some services could realise economies of scale and scope. For instance, schools tend to be small – around 60% of basic schools have less than 200 students – which limits their ability to cater to a larger range of needs (Shewbridge et al., 2016). In very small municipalities overheads may be crowding out spending on other services: administration costs per person were 50% higher in 2013 in municipalities with 100-200 residents than those with 1 000-2 000 residents. Small municipalities also have more difficulties with technical procedures, like public procurement.

Scaling up service delivery does not necessarily mean mergers, although a number of OECD countries have taken this path. In

Italy and Hungary certain services must be provided jointly if municipalities are below a threshold size. France provides financial incentives for co-operation. Non-financial incentives could be used to reinforce financial incentives.

Alternatively, service standards could be imposed to guarantee minimum standards across the country and induce greater co-operation to meet these standards. In any case, the central government should create a unit to monitor co-operation and facilitate co-operation between municipalities, with additional support from regional governments and the representative associations of municipalities. A promising new programme is piloting centres of shared services, which should help mitigate skill shortages, and if successful, should be expanded systematically.

This process should be accompanied by more information about the performance of service providers. Norway's KOSTRA system is an example of best practice in combining and publishing performance information. In the Czech Republic a lot of data already exist but are fragmented or not published. Publishing performance indicators and using them in benchmarking and in budgetary processes would better inform policymakers and provide stronger incentives to providers to raise service quality. It would also help citizens decide whether the right balance has been struck between municipal size and the service quality that they expect.

### **Reference:**

OECD (2016), *Economic Surveys: Czech Republic 2016*, OECD Publishing, Paris.

Shewbridge, C. et al. (2016), *OECD Reviews of School Resources: Czech Republic*, OECD Publishing, Paris, forthcoming.

---

# Tackling the three main challenges in Costa Rica: fiscal reform, reverting the slowdown in productivity and reducing inequality

Category: Costa Rica, fiscal policy, Inequality, Productivity, Uncategorized

written by oecdecoscope | September 23, 2016

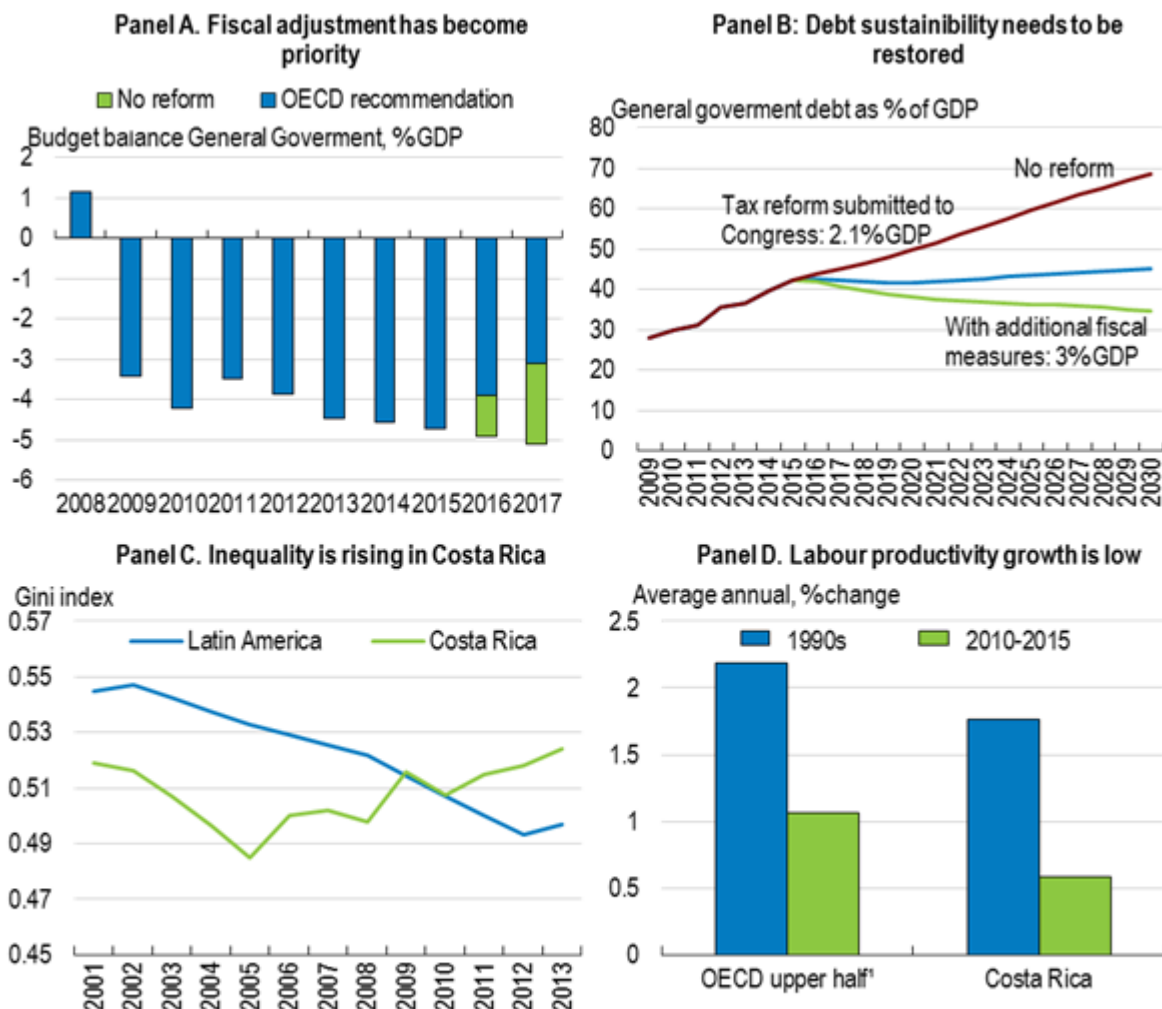
By Paula Garda and Mauro Pisu, Country Studies Branch, OECD Economics Department

Costa Rica's economic, social and environmental achievements are impressive. It has succeeded in combining rising living standards, virtually universal health care, pension and primary education systems with sustainable use of natural resources. Incomes per capita have nearly doubled in real terms over the past three decades and some well-being indicators (health, environment and life-satisfaction) are comparable with or even above the OECD average. However, as the latest Economic Assessment of Costa Rica highlights the country faces old and new challenges that will need be addressed to continue developing in a sustainable way.

In the period 2008-2015, the public debt-GDP ratio almost doubled to 42.4% (Figure 1, Panel A and B) and interest payments on government debt rose from 15 to 19% of central government revenues. The budget deficit reached 6% of GDP in 2015. Measures to restore fiscal sustainability are now urgent.

In addition, Costa Rica faces long-standing structural problems:

- Inequality has been increasing since the mid-1990s to high levels by OECD standards. This is in stark contrast with many other Latin American economies, which have recently made significant progress in reducing inequality and poverty (Figure 1, Panel C).
- Labour productivity growth has been disappointing mainly because of sluggish technical progress. This has taken place despite policies promoting international markets openness and attracting foreign direct investment (FDI) inflows (Figure 1, Panel D).



1. OECD refers to the 17 upper half countries based on GDP per capita; GDP is expressed in 2011 PPP.

Source: OECD (2016), OECD EO99 database; OECD calculations based on the Conference Board Total Economy Database.

**How can policymakers address the three challenges?**

The fiscal challenge is the priority. The two bills the government proposed in 2015 – as part of a tax reform package – to replace the sales tax with a full-fledged VAT system and reform the income tax are still under discussion in the legislative assembly. It is urgent to approve them as soon as possible. The VAT and the income tax reform would cut the deficit by about 2% of GDP over the following two years (mostly due to the introduction of the VAT) and would help stabilise the debt-GDP ratio. The two bills are well thought out and consistent with OECD advice: broadening tax bases and relying more on VAT are growth friendly ways to raise tax receipts. Also, most OECD countries have VAT systems, including Mexico and Chile. Additional fiscal or expenditure control measures of 1% of GDP will be needed to put debt on a firm downward path (Figure 1, Panel B). These should focus on reforming the public employment system to prevent excessive automatic salaries increases and raise public sector efficiency. Reforming the public employment system is key to boost productivity and lower inequality as public administration inefficiencies hamper business dynamism and public sector employment contributes to rising inequality in Costa Rica.

Structural reforms and institutional changes are necessary to increase productivity and build a more inclusive society by reducing inequality and poverty.

The three main areas of reforms to boost productivity include: 1) improving the framework of competition policy by strengthening the power of the competition authority and improving the governance of state-owned enterprises, which play a dominant role in many key sectors such as banking, electricity, insurance and telecoms; 2) enhancing links between the foreign and domestic firms and encouraging innovation by local enterprises through better links with universities; 3) improving transport infrastructure by simplifying the sector institutional framework and

accelerating project execution.

Reforms to increase productivity need to go hand in hand with making Costa Rica a more inclusive society, especially for women. This will require improving the quality of education – and not just increasing spending on it – enhancing the effectiveness of cash transfers– by reducing programmes' fragmentation and improving targeting – and lowering informality – by strengthening enforcement, reducing administrative burdens to entrepreneurship and enabling the poor to become formal workers. Costa Rica should also reinforce environmental protection by reducing emissions from the transport sector and improving wastewater treatment.

**Find out more:**

OECD (2016a), OECD Economic Surveys: Costa Rica 2016, OECD Publishing, Paris.

---

## **Reaping the benefits of global value chains to rebalance the Turkish economy**

Category: Turkey,Uncategorized

written by oecdecoscope | September 23, 2016

By Volker Ziemann, Economist, Turkey Desk, Country Studies Branch, OECD Economics Department

The growing role of global value chains (GVCs) in international production processes is of critical importance for Turkey's development. Participation in GVCs is one of the key drivers of successful productivity diffusion in a

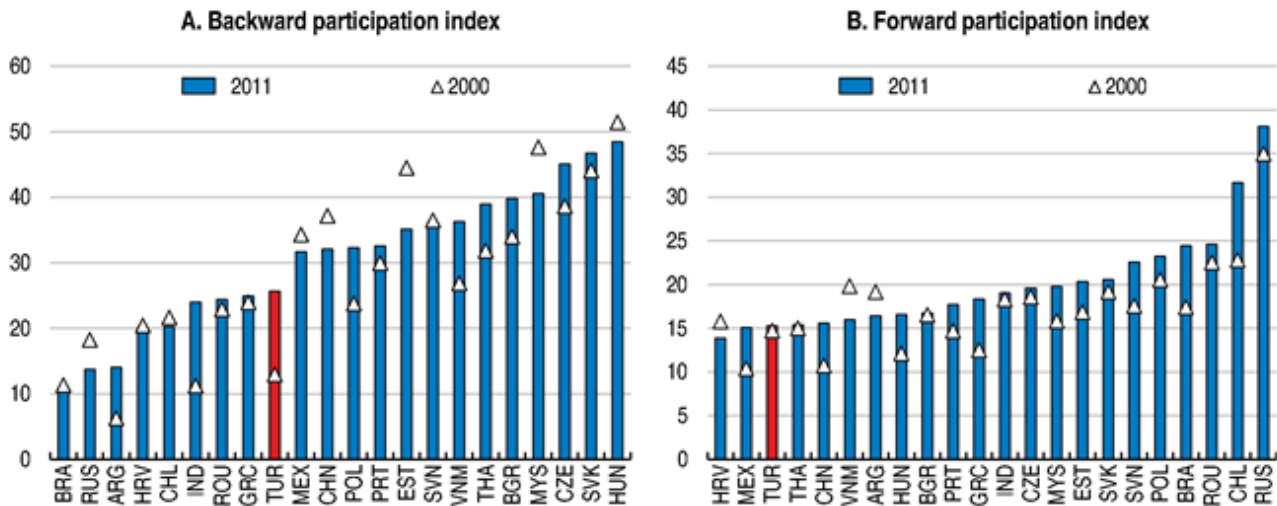
globalised world. Despite major progress, Turkey still lags behind most comparable countries in terms of exported value added per capita.

Backward integration, that is the use of foreign inputs to produce final and intermediate goods exported by Turkish firms, often entails import competition, in particular in manufacturing and services, and accelerates the reallocation of domestic resources towards the most competitive firms. Backward integration also facilitates the diffusion of knowledge either indirectly through learning from suppliers or directly via knowledge spillovers from foreign direct investment.

Forward integration, that is the production of intermediate inputs used in other countries' exports, increases and diversifies the potential market, leverages the use of Turkey's human, capital and natural resources, and, as a result, contributes to rebalancing the Turkish economy. Increased production for foreign markets requires convergence of product standards toward international best practices and triggers virtuous feedback loops between productivity, innovation, human capital endowment and living standards.

While Turkey incorporates an increasing share of foreign value added in its own exports (backward participation), its capacity to provide intermediate inputs to other countries' exports (forward participation) is still limited (see Figure).

## Participation in global value chains is relatively low



Note: The backward participation index is defined as the share of foreign value added in a country's gross exports. Forward participation is defined as the ratio of domestic value added embodied in foreign countries' exports over gross exports.

Source: OECD/WTO (2016), "Trade in value added", OECD-WTO: Statistics on Trade in Value Added (database). DOI: <http://dx.doi.org/10.1787/data-00648-en>.

The 2016 OECD Economic Survey of Turkey argues that Turkey's participation in GVCs remains below potential owing to institutional features that hamper efficient allocation of capital and labour, obstacles inherent in bilateral trade agreements and entry regulations, underdeveloped human capital and insufficient investment in innovation, R&D and knowledge-based capital. The Survey further identifies substantial room for progress in corporate governance and managerial skills, as well as the use of ICT tools in production and management processes.

Progress along these dimensions would make Turkish firms more competitive, strengthen Turkey's backward and forward trade linkages and contribute to rebalancing growth. The adjustment process towards a more export-oriented economy operating on a level playing field needs to be flanked by dedicated industrial, social and environmental policies to alleviate adverse consequences on displaced firms and workers and the ecosystem.

## Find out more:

OECD (2016), *OECD Economic Surveys: Turkey 2016*, OECD Publishing, Paris.

---

# Strengthening the Turkish manufacturing sector to rebalance growth

Category: Productivity, Structural reform, Turkey, Uncategorized  
written by oecdecoscope | September 23, 2016

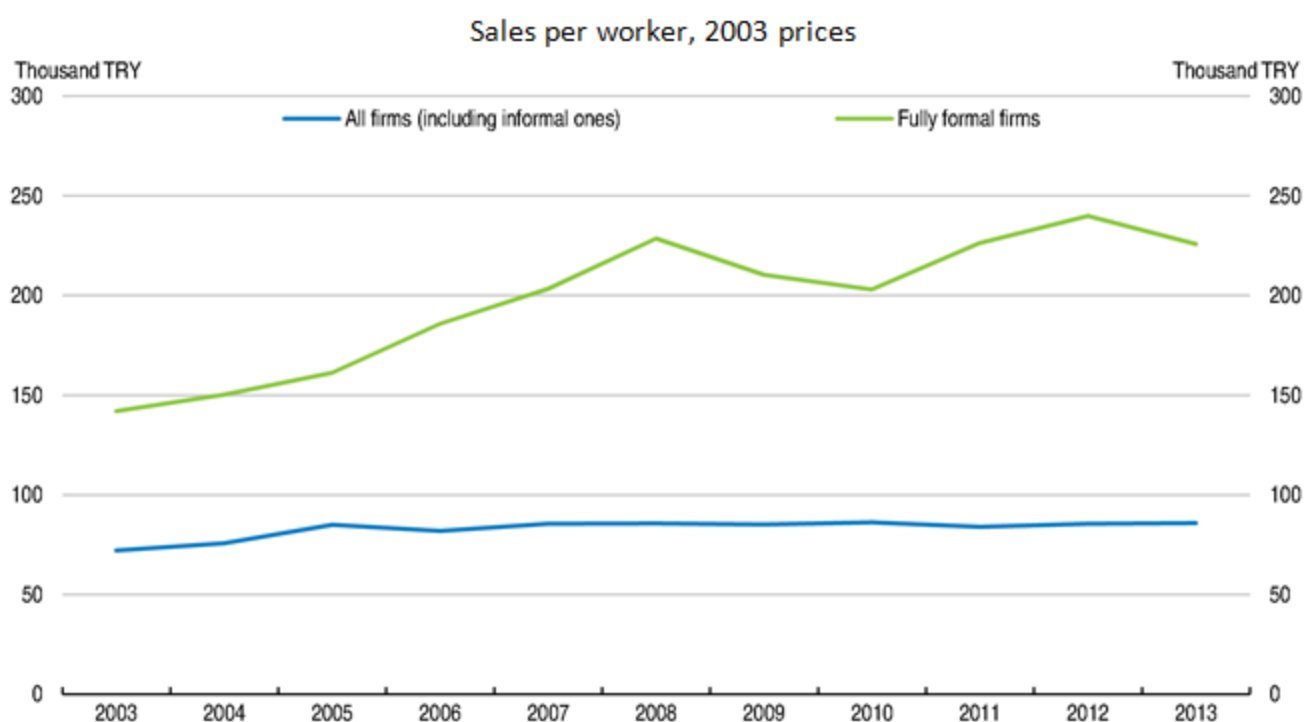
By Rauf Gonenc, Head of the Turkey Desk, Country Studies Branch, OECD Economics Department

Turkey's economy continued to grow strongly despite substantial domestic and regional headwinds. However, external imbalances have widened making the economy vulnerable to external shocks. The *2016 OECD Economic Survey of Turkey* calls for rebalancing to alleviate the enduring tension between growth and external sustainability. A more competitive manufacturing sector, with a heavier weight in the economy and higher net exports is key here.

The *Survey* documents drivers and bottlenecks for the growth and diversification of Turkey's manufacturing sector. It suggests that the sector's segmentation and the outsized tail of poorly performing firms undermine aggregate productivity growth. Indeed, low productivity eases job creation in the short term, but undermines it in the long run and holds back improvements in living standards because of competitiveness losses. A core of well-performing firms ("frontier firms") is

not growing at full potential because of shortcomings in the policy framework. Intermediary (“follower”) firms sustain competition and deliver jobs, but tend to fall behind in productivity. Lower productivity units (“laggards”), which employ a large share of the low-skilled majority of the working age population, survive mostly thanks to the incomplete enforcement of rules and regulations. The resulting stalemate requires a coherent strategy of “systemic upgrading” of the business environment.

### Informality drags down productivity



Source: Turkish Statistical Institute; Central Bank of the Republic of Turkey.

A number of structural features entrench the deep segmentation between different types of firms, hinder productivity diffusion and curb higher-productivity firms’ share of total employment:

- Human capital falls behind reflected in weak general management know-how, foreign language proficiency and basic digitalisation knowledge of business owners, as well as limited access to vocational training for their employees.
- Lack of formalisation and transparency hampers firms’

access to banking and financial services, to the stock market and to international partnerships.

- Notwithstanding improvements in the 2000s, the credibility of governance institutions needs to be improved further. Young firms are particularly affected by pressures arising from illicit practices, non-level playing competition and political unpredictability.
- Turkey's rigid employment regulations deprive law-abiding enterprises of the wide range of employment forms available in other OECD countries. More flexible employment forms are accessible for informal and semi-formal businesses. These jobs, however, are precarious and lack social protection.

Removing these bottlenecks would allow Turkish firms to operate in compliance with the law and on a level-playing field, under supportive regulations, taxation and innovation incentives. They could then achieve stronger productivity gains and the most promising firms could grow faster. A credible flexicurity system needs to be put in place that facilitates adjustment in the labour market while protecting those affected by structural change.

**Find out more:**

OECD (2016), *OECD Economic Surveys: Turkey 2016*, OECD Publishing, Paris.

---

**Leveraging R&D and innovation policies to foster**

# productivity in Czech Republic

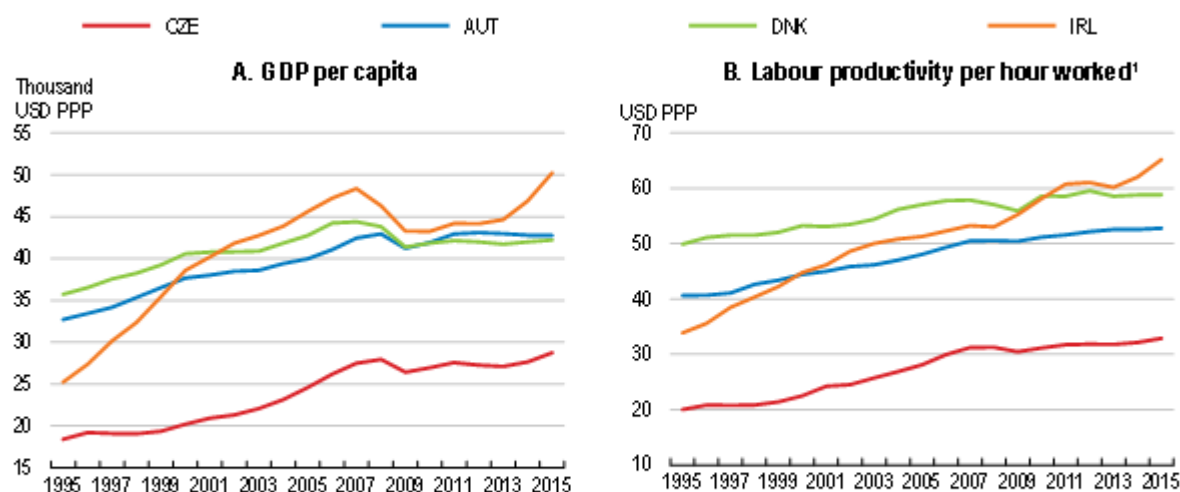
Category: Czech Republic, Innovation, Productivity, Uncategorized  
written by oecdecoscope | September 23, 2016

By Falilou Fall, Head of the Czech Republic Desk, Country Studies Branch, OECD Economics Department

Productivity catch-up along with deeper integration into the global economy played a central role in the convergence of the Czech incomes toward OECD countries before the 2008 financial crisis. However, since then the convergence process has stalled. Labour productivity trends show a clear break in 2008 at the beginning of the crisis (Figure 1). The growth rate of labour productivity fell from 4.3% per annum in 2001-07 to 0.4% between 2008-14, and affected all sectors except finance and insurance. The strongest decrease was in manufacturing.

As a result productivity is 21% below its pre-crisis trend, and potential productivity is 16% lower (OECD, 2016; Fall and Lewis (2016, forthcoming)). While cyclical developments are at play, the drop in productivity in all sectors indicates that the productivity shortfall is mainly structural. This suggests scope for improved structural policies to boost productivity in the Czech Republic.

Figure 1. Stalled convergence of the Czech Republic



1. 2015 data for the Czech Republic and Ireland are estimates.

Source: OECD Productivity database; OECD National Accounts database; OECD calculations.

Until 2008, inward foreign direct investment, international linkages of firms and credit availability had a significant impact on productivity growth. As the Czech economy is already one of the most integrated in global value chains, reviving the productivity catch-up process has to be domestically-driven. In particular, there is a need to boost productivity of Czech firms not affiliated to foreign firms and to facilitate the expansion of SMEs and the creation of new firms (Adalet McGowan et al., 2015).

More effective R&D and innovation (RDI) policies are needed to foster domestically-driven productivity growth. So far, R&D and innovation performance has been low despite a noticeable increase in spending. The increase in RDI spending should be continued as it is a key element for upgrading the economy in the global value chains. The Czech Government has put in place programmes to encourage higher business R&D spending by intensifying collaboration between businesses and research institutions. However, direct government funding of business RDI is modest, representing 0.1% of GDP in 2013. More co-financing should be developed to incentivise firms to mobilise their own resources. Well designed and properly administered tax incentives (fiscal deductions) for RDI should also be used

to complement direct support. However, a balance should be maintained between different types of government funding through grants, loans, co-financing, loan guarantees and tax provisions.

Furthermore, streamlining the administration and implementation of innovation policy would increase the effectiveness of the different programmes. The organisation and administration of RDI policies is too complex. The fragmentation of innovation policies seems to be partly driven by the specialisation of the different government bodies along with a limited set of financial instruments available to each. The respective role of the different stakeholders (ministries, agencies, research institutions, councils and businesses) should be further clarified as they all intervene in the same areas. Also, it is necessary to unify the design, assessment and coordination of implementation of research and development and innovation policies in a single institution.

## **Reference**

Adalet McGowan, M., D. Andrews, C. Criscuolo and G. Nicoletti (2015), *The Future of Productivity*, OECD Publishing, Paris,

See:

<http://www.oecd.org/economy/the-future-of-productivity.htm>

OECD (2016), *Economic Surveys: Czech Republic 2016*, OECD Publishing, Paris.

Fall, F. and C. Lewis (2016), "Fostering productivity for inclusive growth in the Czech Republic", forthcoming, OECD Publishing, Paris.