

New long-run scenarios: A path to offset CO2 mitigation costs

Category: Uncategorized

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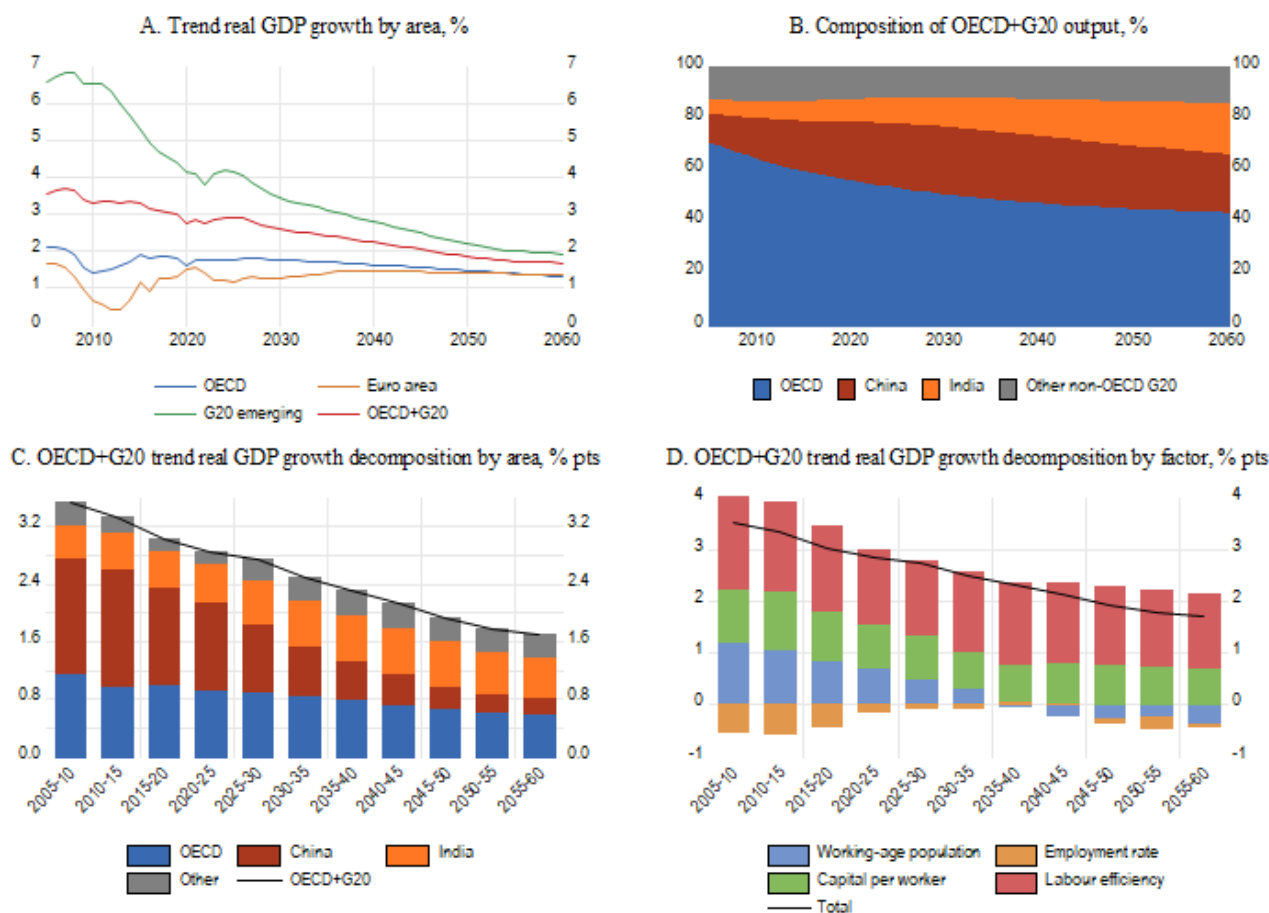
by Yvan Guillemette, OECD Economics Department

Every 2-3 years, the OECD Economics Department publishes a set of country-level economic scenarios to 2060 to quantify some of the most important long-term macroeconomic trends and policy challenges facing the global economy. The latest update includes the standard 'business-as-usual' scenario, in which no major reforms to government programmes are undertaken and progress on energy efficiency and energy decarbonisation continues along recent trends. For the first time, the update also describes a stylised scenario in which OECD and non-OECD G20 economies successfully transition to low-carbon energy in a way broadly consistent with a net-zero target for greenhouse gas emissions by 2050. While this represents a negative supply shock to all economies, the upshot of the analysis is that fiscal and structural reforms could fully offset the output costs associated with mitigation efforts over the first 10 years of the energy transition.

In the baseline scenario, global CO₂ emissions from energy use remain around current levels, a trajectory incompatible with the UN Paris Agreement's ambition of limiting warming to 1.5°C. This failure occurs despite trend annual real GDP

growth for the combined OECD+G20 area gradually declining from around 3% pre-COVID to 1.7% by 2060, mainly due to falling working-age population growth and a deceleration of trend labour efficiency growth in emerging-market economies. China and India continue to account for most of global growth, with India's contribution surpassing China's in the late-2030s.

Figure 1. The baseline scenario in a snapshot



Note: 'G20 advanced' includes Australia, Canada, Germany, France, the United Kingdom, Italy, Japan, Korea and the United States. 'G20 emerging' includes Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, Türkiye and South Africa. The OECD+G20 aggregate includes all OECD and non-OECD G20 countries.

In per capita terms, growth in the OECD area remains stable,

around $1\frac{1}{2}$ per cent per annum, below historical norms. Real GDP per capita growth is projected to slow in most of the G20 emerging-market economies, except those where recent performance has been relatively weak (including Argentina, Brazil and South Africa).

In the energy transition scenario, all countries accelerate their CO₂ mitigation efforts as of 2026, eliminating coal as an energy source by 2050 and lowering oil and gas shares in total energy supply to 5% and 10%, respectively. Abstracting from gains due to avoidance of environmental damages, this acceleration of the energy transition leads to a reallocation of resources that impact GDP negatively. Global growth slows by 0.2 pp per annum initially relative to the baseline scenario, and by 0.6 pp toward the end of the transition period. The slowdown is more modest in the OECD area, but sharper in the G20 emerging-market area given higher carbon intensity.

An increase in carbon taxation sufficient to bring about the transition could bring in around $3\frac{1}{4}$ per cent of GDP in additional government revenue in the OECD area over the 2026-2030 period. In the basic energy transition scenario, this extra revenue is channelled back to households as a direct transfer. However, an alternative scenario assesses a tax shift strategy in which revenue from higher carbon pricing is used to lower the tax burden on labour (labour tax wedges). Dynamics are important here because revenue from carbon pricing first rises, but later declines along with CO₂ emissions, implying that tax wedges could be lowered, but would eventually have to rise again. Nevertheless, because higher carbon pricing is politically awkward to implement, the tax shift strategy could facilitate the phasing in of higher carbon taxes, allowing at least the initial part of the energy transition to benefit from the greater efficiency of a price-induced transition.

Via positive effects on employment, this tax shift strategy is shown to fully offset the decline in output otherwise associated with the first 10 years of the energy transition, leaving living standards in 2035 higher than in the baseline scenario in the OECD area and most individual countries. At peak impact around 2035, the euro area and OECD aggregate employment rates are around 1½ pp higher than without the tax shift.

Figure 2. Shifting tax burden from labour to carbon offsets most transition costs to 2035

Level of potential output in 2035, % difference between scenarios (see legend and note)



Note: Blue bars show the % difference in the level of output in 2035 in an energy transition scenario with carbon revenue rebated as lump sums versus the baseline scenario. Orange bars show the % difference in the level of output in 2035 in an energy transition scenario with carbon revenue used to lower tax wedges versus when it is rebated as lump sums. Diamonds show the % difference in the level of output in 2035 in an energy transition scenario with carbon revenue used to lower tax wedges versus the baseline scenario, which corresponds to the sum of blue and orange bars. Chile, Colombia, Costa Rica, Mexico, Norway and Türkiye are not shown as these countries do not have a fiscal block in the OECD Global Long-Term Model.

Additional scenarios show that deploying the extra revenue into a combination of higher R&D expenditure and support for childcare would have similar effects. Other structural reforms, such as product market liberalisation and improvements in governance could also help to offset the output costs of CO₂ mitigation.

Reference

Guillemette, Y. and J. Chateau (2023), "Long-term scenarios update: incorporating the energy transition", *OECD Economic Policy Papers*, No. 33, OECD Publishing, Paris, <https://doi.org/10.1787/153ab87c-en>

Restoring growth

Category: Ageing, Inflation, trade

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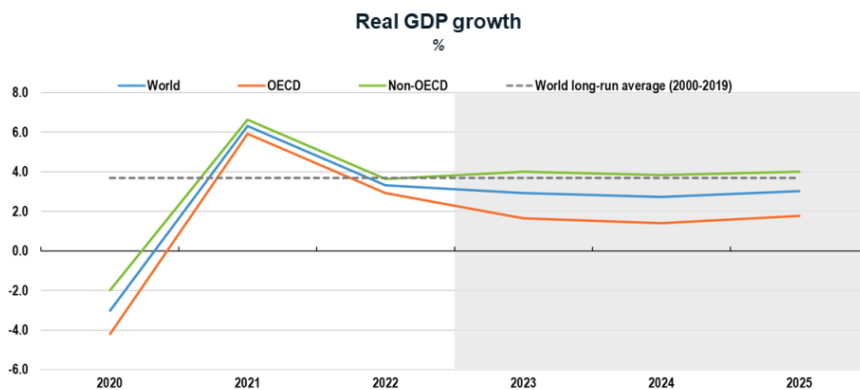
by Clare Lombardelli, OECD Chief Economist

Inflation is easing, but growth is slowing. The tightening of monetary policy needed to tackle inflation is taking effect. Despite stronger-than-expected GDP growth in 2023, tightening financial conditions, weak trade, and subdued confidence are taking a toll. Housing markets and bank-dependent economies, particularly in Europe, are feeling the impact.

The pace of growth is uneven. Emerging markets are generally

faring better than advanced economies. Europe's growth lags behind North America and major Asian economies. Inflation, while easing, remains a concern.

Global growth is expected to remain modest



Note: Long-run average covers annual world GDP growth over 2000 to 2019. Shaded area indicates projection period.
Source: OECD Economic Outlook 114 database; and OECD calculations.

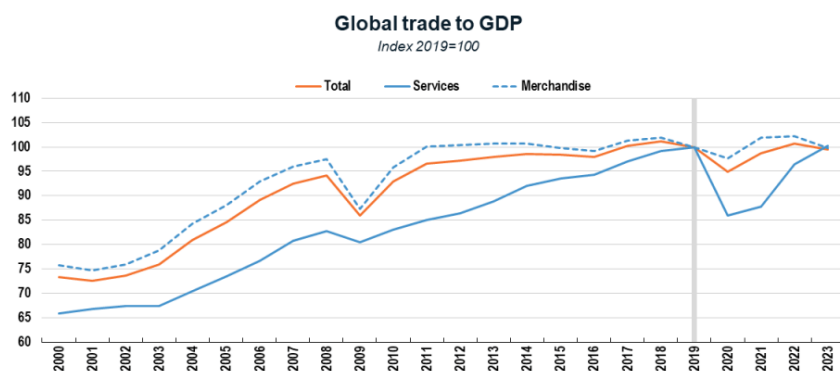


We are projecting a soft landing for advanced economies, but this is far from guaranteed. The relationship between inflation, activity and labour markets has changed, making the full impact of monetary policy tightening hard to judge. In the United States, the economy is demonstrating more strength than expected, and there is a risk that inflation proves to be persistent. In the euro area, the full impact of tighter monetary policy is still to appear and activity may be hit more strongly than we expect.

Many emerging markets have shown considerable resilience over the past year, but countries characterised by structural debt vulnerabilities have come under market scrutiny.

Global trade is weak. Not only cyclical, but also structural factors are causing a slowdown in the rate at which value chains are integrating across countries. Opportunities for growth, particularly from greater services trade, are being missed. We must revive global trade. Resilience in global value chains is best delivered by diversification, not by protectionism and inward-looking policies.

Trade growth has stalled



Note: Trade volumes are based on the average of exports and imports, converted to USD. 2023 figure is based on the average of Q1 and Q2.
Source: OECD Economic Outlook 114 database; OECD calculations.



In many countries, fiscal pressures are mounting. Demographic changes, decarbonisation, and a combination of rising interest payments and slow growth mean countries face a challenging fiscal outlook. Governments need to take bold action to reduce such pressures and give a greater focus to growth in their policy making. That means reforming labour market and pensions policies, increasing competition, and using fiscal levers to increase human capital and productivity enhancing investment, including the investment needed to deliver the green transition.

In summary, the global economy is grappling with inflation, slowing growth, and mounting fiscal pressures. Policymakers must prioritise macroeconomic stability, structural reforms, smart fiscal policies and international cooperation to foster sustainable and inclusive growth.

For more info and data visit:
www.oecd.org/economic-outlook/november-2023/

References

OECD (2023), *OECD Economic Outlook, November 2023: Restoring Growth*, OECD Publishing, Paris

Getting stronger, but tensions are rising

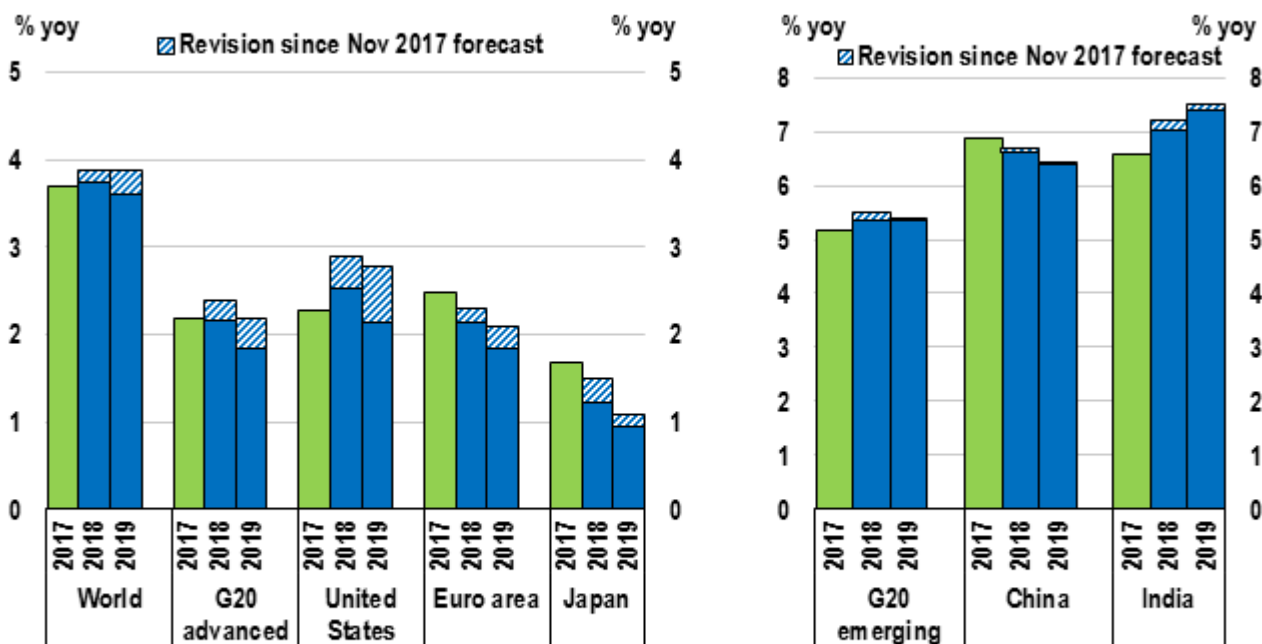
Category: Economic outlook, investment, trade, Uncategorized

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By Álvaro Pereira, OECD Acting Chief Economist

The global economic expansion is strengthening. Global growth is projected to increase from 3.7% in 2017 to around 4% in 2018 and 2019 in our latest *Interim Economic Outlook*. In many advanced and emerging G-20 economies, the growth prospects for the next two years have improved. Global trade and investment are growing faster, accompanied by robust job creation. Fiscal stimulus in the United States and Germany will further boost short-term growth. Commodity exporting emerging market economies are recovering on the back of stronger commodity prices and firmer global demand. Inflation remains low, but is likely to rise slowly as labour markets tighten.

GDP growth projections



Note: GDP in volume. Fiscal years starting in April for India. The G20 aggregate does not include EU countries that are not G20 members in own right. G20 emerging includes Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, Turkey and South Africa, and G20 advanced includes all other G20 economies.

Source: OECD Economic Outlook database.

This is welcome news. However, there are also new tensions and new policy challenges. As the expansion progresses, monetary policy support will be reduced gradually, albeit at different speeds across major advanced economies. The likelihood of faster hikes in US policy rates has already been reflected in slightly tighter short- and long-term financing conditions. Such policy normalisation is desirable, but could expose financial vulnerabilities from accumulated debt and high asset prices. Rising interest rates could create particular challenges for emerging market economies if capital flows and exchange rates were to become more volatile.

Against the positive background, an escalation of trade tensions is a serious risk. US steel and aluminium tariffs will raise costs and harm consumers, while not solving the global overcapacity problem. Escalation of trade tensions would hurt the recovery. Safeguarding the rules-based international trading system is key.

Policymakers need to make the right choices to sustain medium-term prosperity and ensure the benefits are fairly shared by workers and households. Fiscal policy, while it remains supportive, should not excessively stimulate demand. Focusing on changes in the tax mix and spending structure holds significant potential to make growth more sustained and more inclusive in the medium term.

Keeping an eye on medium-term goals also means stepping up reform efforts to boost productivity, employment and inclusion. Some countries – Italy, France, Japan, India and Argentina – have implemented significant reforms. However, our forthcoming *Going for Growth* report (to be released on 19 March) shows that in both advanced and emerging economies overall, the pace of structural reform is once again slowing, particularly on the tax and skills policies that are so important to achieving inclusive growth. Political support for reform can dwindle in good times. Yet, good times do provide an opportunity to implement ambitious policies to develop

workers' skills, promote competition, and improve the functioning and inclusiveness of labour markets so that living standards rise durably and widely across society.

Reference

OECD Interim Economic Outlook, March 2018.