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OECD INTERIM ECONOMIC OUTLOOK

Right on stronger fiscal policy action, silent on wages

September 2016

The OECD released its autumn interim Economic Outlook on the 21 September against the background of growing concern amongst some policy makers about "a populist backlash against trade agreements" fuelled by stagnant growth.

Growth forecasts for the global economy broadly remain the same (around 3%, much lower than the 1995 – 2007 average of 4%). Relatively significant downwards revisions have been applied to the UK (revision of minus 1%), to Italy (revision of minus 0.2% this year and minus 0.6% next year) and the US (revision of minus 0.4% this year). Japan and Brazil are slightly upgraded.

<u>The overall key message is that the world economy remains in a low growth trap,</u> as has been the case since 2011. This repeats the message conveyed in the June Economic Outlook and the February interim forecast of the need for fiscal expansion, however there are some shifts in the assessment:

1. The OECD is not just stressing that **monetary policy is overburdened** but is also warning about financial distortions and risks (overvalued asset prices with the risk of sharp correction, equity prices out of line with profit growth, distress for the banking sector, undermining solvency of pension funds and insurance groups – steadily undermining workers' pension rights). The OECD hence is cautious of "any decision to increase the scope of unconventional policies" but refrains from calling for a turn-back of such policies ("maintain existing monetary policy support").

2. The OECD continues to call for **stronger collective fiscal policy action**. With Canada, Japan and the United States recently announcing fiscal expansion measures, and with the UK signalling an easing in the fiscal stance, the focus shifts to Euro Area countries. These, according to the OECD, could do more to make use of exceptionally low interest rates. To do so, "the application of the EU Stability and Growth Pact" should be modified (…), for example by excluding net investment spending from

fiscal rules (…)". This is accompanied by a graph showing that Italy and France are enjoying budget gains over 2015 to 2017 thanks to falling government interest payments of 1.5 to 2% of GDP.

3. The structural reform agenda is re-framed from '**reforms that strengthen globalisation to boost growth', to 'reforms that strengthen globalisation to boost growth, while sharing the benefits**'. Going on the counteroffensive against what it sees as "rising protectionism", the OECD states that "trade is an important driver of productivity growth, enhancing competitive pressures, enabling greater specialisation and resource allocation and facilitating knowledge transfer". The outlook calls on to avoid or roll back new protectionist measures, remove tariff and non-tariff barriers, remove regulatory restrictions on trade in services, remove distortions for cross border investment.

The outlook **lacks any reference to financial and banking "structural reforms"**. It acknowledges that banks are in overcapacity and that their business model is at serious risk, but stops short of any policy recommendations.

While the OECD recognises that "policy packages should make sure that the benefits of higher growth are shared broadly", it seems to come as an added reflection and reiterates the rather traditional policy recommendations of investing in skills, human capital and active labour market policy. Here, the reference to **improving social safety nets during job transitions** is welcome. The OECD however does not specify further what this would mean for policy in practical terms.

At the same time, **any reference to the role of wage formation and collective bargaining in sharing the benefits of growth is absent**, and this despite the well-established fact that, even with the trend of productivity dynamics slowing down, (real) wage growth is staying systematically behind productivity in the overwhelming majority of OECD countries, thereby depressing the share of labour in GDP, while boosting the share of profits and triggering increased inequalities in that way.

The only reference to the role of wages is a highly ambiguous and inadequate one: to "promote competition amongst firms to underpin more robust competition for markets and workers". In other words, if wages are to rise then this should be the outcome of a market process with firms competing with each other for workers. This fails to acknowledge that the relationship between individual workers and management is not an equal one and that this often results in depressed wage outcomes. To respond to the demise of the middle class in the US and fears about the ongoing 'race to the wage bottom' in Europe, the labour/management question needs to be addressed as well. Household incomes in the US have recently seen a welcome increase not just because of the market but largely due to public interventions to shore up wages in the form of state level increases in minimum wages.