



International Monetary and Financial Committee

Thirtieth Meeting
October 11, 2014

**Statement by Mr. Angel Gurría,
Secretary-General, OECD**

On behalf of the Organisation for Economic Co-operation and Development (OECD)



Annual Meetings of the IMF and World Bank

Written Statement for the IMFC

**Angel Gurría,
Secretary-General
OECD**

11 October 2014

Washington, United States

Global Economic and Financial Outlook: Divergence and Disconnect

As a result of continued policy support and favourable financial conditions, global growth is expected to be somewhat more vigorous in the latter part of 2014 and into 2015.¹ Nonetheless, the OECD's recent Interim Assessment has revised growth projections downwards for most major economies (by around 0.4% for the G7) as the recovery is turning out to be weaker than expected. Growth rates remain well below those seen before the crisis, and there is a growing degree of divergence between the major economies. For example, while North America is expected to continue growing at a solid pace through 2015, growth in the Euro area looks set to remain subdued in the near term as weak domestic demand and low inflation raise the risks of prolonged stagnation. Growth is around trend in Japan and China, and is strengthening in India after the recent weak patch.

The moderate rate of growth means that a substantial degree of labour market slack remains across the advanced countries, and world trade growth remains sluggish. A number of countries are encumbered by high debt ratios and still face significant structural and fiscal challenges. Confidence is again weakening.

Meanwhile, the recovery from the crisis has been characterised by existing and emerging imbalances that are giving rise to a build-up of financial market risks. The divergence in growth and policy settings among the major economies could increase asset price volatility and put emerging market economies under renewed pressure. Moreover, the protracted low-interest-rate environment has encouraged rising corporate leverage, which has not translated into strong growth in investment. Companies have, to a large extent, been using cash and borrowed funds for share buy-backs. In the case of high-yield bonds, liquidity risk is potentially a major problem, especially for emerging markets.

With continued liquidity support from major central banks, financial markets have remained bullish despite the lacklustre pace of global growth and the worsening of some important risks. Even in the face of rising geopolitical tensions and increasing public and private debt ratios, some equity markets have reached record highs, sovereign bond yields in several countries are near all-time lows and implied share price volatility in the United States and Europe is around pre-crisis levels. The disconnect between weak global growth and bullish financial markets suggests a mispricing of risk that could result in a sudden correction.

Macroeconomic and financial policy requirements

The divergence in major economies' positions in the economic cycle is reflected in diverging macroeconomic policy requirements. As regards monetary policy, the euro area needs more vigorous stimulus, whereas the United States and the United Kingdom are moving to the end of their unconventional monetary easing. Although the output gap in Japan has closed, further quantitative easing is still needed to secure a lasting break with deflation and offset the drag on demand from fiscal consolidation. Policy settings in China appear consistent with achieving an orderly growth slowdown, with ebbing inflation pressures providing ample room for stimulus if needed. By contrast, inflation remains above target in Brazil and India and monetary policy will need to remain restrictive.

Government debt burdens remain heavy in the major advanced economies, but progress has been made in fiscal consolidation. Given the weakness of demand in the euro area, the full degree of flexibility available within the EU fiscal rules should be used to support growth. In Japan, by contrast, much-needed consolidation is just beginning and the challenge to ensure debt sustainability is substantially greater than in the other major economies. In the United States, consolidation needs are less pressing, but medium-term consolidation plans are still required to keep public debt on a sustainable path.

Among the major emerging economies, the main need for durable improvements in the budget balance arises in India and Brazil. In India, the quality of consolidation should be improved, with a shift in expenditure from subsidies to social and physical infrastructure. Redesigning the fiscal rule in Brazil to take account of the business cycle, for example by adopting an expenditure rule, would make a credible commitment to the necessary improvement in the primary balance as the economy recovers.

Some progress has been made towards repairing the credit transmission mechanism in the euro area, but more is needed. The decisions taken to establish a single supervisory mechanism and a single resolution mechanism are welcome. However, the resources envisaged for bank resolution risk are inadequate and the decision-making process too complex, suggesting a need to strengthen these aspects of the new architecture. Additional structural bank reforms are also needed to tackle too-big-to fail and interconnectedness issues. The G-20 initiative on structural banking reforms led by the Financial Stability Board (FSB), with contributions from the OECD and the IMF, is therefore welcome. The OECD will take stock of the consistency of regulatory requirements with the OECD Codes of Liberalisation of Capital Movements and report to the FSB by end-2015.

The financing of investment is also becoming more crucial. Given the sluggish post-crisis growth of investment in many major economies, obstacles to lending to the real economy must be removed. A broader range of policies is needed to incentivise risk taking, and overcome investors' reluctance to invest in the real economy, in innovation, SMEs and infrastructure. The OECD has been supporting such efforts, in particular via its work on Institutional investors and long-term investment spearheaded by a G20/OECD Task Force. The OECD has also launched a large Network on Institutional Investors and Long-Term Investment, gathering private sector representatives engaged in long-term investment business, with the objective of further developing consultation and dialogue. Continued efforts to open up trade and reduce barriers to foreign direct investment will also be important. On the investment front, the OECD's Policy Framework for Investment offers a comprehensive and systematic approach to improving investment conditions, and is now being updated and enriched to build on countries' experiences to date.

Boosting employment and improving job quality

While stronger growth will support higher levels of employment, labour market policies and other innovative policy tools are also required to get people back to work. The OECD unemployment rate, which reached a historic 8.5% in October 2009, and which seemed stuck at 7.9% in 2011-2013, fell to 7.3% in June of this year.ⁱⁱ However it is moving at very slow speed. Seven years after the onset of the global financial crisis, only half of the surge in unemployment will have been reversed. In fact, by the end of next year, almost 45 million people will be unemployed in the OECD area – 12 million more than before the crisis.ⁱⁱⁱ

While wage cuts during the crisis have helped contain job losses and restore competitiveness in countries with large current account deficits, further reductions may be counterproductive by holding back demand. Furthermore, wage moderation during the crisis has not been fully translated into lower prices. While this partly reflected firms' necessary efforts to restore profitability, it was also driven by insufficient competition. Further structural reforms to enhance competition in product and services markets are therefore vital. It is also necessary to make it easier for workers to move between sectors and firms. Providing work experience and training to jobseekers, as well as those in employment, can help foster this labour mobility.

Low-paid workers and their families are most at risk of hardship from cuts in real wages. It is important to look beyond the level of wages to look at their distribution. Mandatory minimum wages now exist or are being implemented in 26 OECD countries, as well as in a number of emerging economies.^{iv} When set at the right level, these can help underpin the wages of low-paid workers without having adverse effects on employment.

Addressing gaps in employment protection between permanent and temporary workers is another priority. The 2014 OECD Employment Outlook shows that when these gaps are excessive, the impact of a downturn on job losses is greater, especially among those in "atypical" and precarious jobs. In emerging-markets and many developing countries informal and un-protected employment looms large, and addressing gaps in effective employment protection must go hand-in-hand with the broader challenge of expanding the scope and coverage of social protection.

Finally, there should be a greater focus on the quality of jobs, and their impact on wellbeing. The 2014 OECD Employment Outlook outlines a new framework for assessing job quality along three main dimensions: the level and distribution of earnings; job security; and the quality of the work environment. Overall, there is little sign of a trade-off between job quantity and job quality across countries. In other words, implementing policies that help improve job quality should not result in fewer jobs. There are, however, wide differences in job quality across countries and between socio-economic groups, with youth and low-skilled having lower quality jobs.

Achieving strong, sustainable and inclusive growth

While macroeconomic and labour market policies are necessary to boost growth and promote employment, broader structural reforms are vital to achieve strong sustainable and inclusive growth.

Income inequality in OECD countries is at its highest level for the past half century and has intensified during the crisis. Anchored poverty has increased by about 2 percentage points between 2007 and 2011, with much larger increases in countries such as Greece, Ireland and Spain which were hardest hit by the crisis. And inequality goes beyond income. Rising inequality in income is often accompanied by growing exclusion in the labour market, lower intergenerational social mobility, and greater polarisation in educational and health outcomes. And these widening inequalities of outcomes often reflect widening inequalities of opportunity. The OECD's Inclusive Growth framework explicitly recognizes this multidimensionality of inequality and proposes policy measures to address it through achieving inclusive growth.

First, in order to promote inclusive growth, labour market policies must be accompanied by targeted reforms to support stable employment. The policy aim must be to equip all people with the competences and support necessary to take advantage of their circumstances and to adapt when these circumstances change. Providing people with better skills is imperative. This is increasingly a life-long process, but for maximum effectiveness policy interventions must address income, wealth and health inequalities from the youngest ages. For example, investment in early childhood education and care has great payoffs in developing resilience. As for the problems facing youth, the OECD's Youth Action Plan is helping countries implement policies to ensure that no one is left without education, training or employment.

Responding adequately to the disadvantages faced by women requires policies to promote a more gender-equitable labour market, including affordable and high-quality childcare, providing incentives via the tax-benefit system for both partners to work, and challenging discrimination. The elderly are today the least unequal part of the population, reflecting decades of near-full employment and limited wage inequality, but those conditions have changed. A "job for life" and even a career for life are no longer a reality. Growing inequalities in the wellbeing of older people will strain existing welfare systems and jeopardise the effectiveness of recent reforms in labour markets, pension systems and long-term care arrangements.

Second, there needs to be a greater focus on developing new policy advice on innovation, science and technology, and the digital economy. Knowledge Based Capital (KBC) will be key in the future: in the US and the EU, KBC already contributes more than 20% to average productivity growth.^v Policies need to favor investment in KBC such as: research & development; software and big data; organisational know-how and intellectual property.

Third, there needs to be a collective effort to fire-up the engine of trade and find ways to help countries increase their participation in international trade flows. The OECD has designed a new metric to measure global trade flows – Global Value Chains (GVCs). GVCs challenge our conventional wisdom on how we look at economic globalisation and in particular, the policies that we develop around it. The OECD is working on several fronts to help policy makers better understand the effects of GVCs on a number of policy domains including: trade policy; investment policy; and risk assessment. Momentum must also continue to tackle barriers to trade, particularly in the services sector, which today represents almost half of value added exports. Services make up more than two-thirds of gross domestic product (GDP) globally, employ the most workers in major economies, and create more new jobs than any other sector. Implementation of the Bali Trade Facilitation Agreement could be pursued.

Fourth, there must be greater efforts to promote green growth. The world urgently needs to make the shift to a low carbon economy. New OECD projections carried out under NAEC suggest that world GDP in 2060 may cumulatively shrink by between 0.7% and 2.5%, should global temperature increase between 1.5° and 4.5°C.^{vi} The UN process will be central in catalysing action and securing the necessary political will to finalise an ambitious, global legal climate agreement at COP 21 in 2015. The OECD *Green Growth Strategy* highlights the importance of eliminating fossil fuel subsidies, introducing an appropriate price on carbon and removing barriers to the mobilisation of investment in green technologies. But these environmental policies won't be sufficient to achieve the transition to low carbon-economies. Many other policies in areas including tax policy, regulatory policy, or urban planning also have an impact on the amount of carbon emitted as well as on cost and hence need to be aligned with our goal of achieving zero net

emissions in the second half of this century. Together with the International Energy Agency, the Nuclear Energy Agency and the International Transport Forum the OECD has launched a project to explicitly look at these non-environmental policies and see how they could be better aligned with the low-carbon transition.

Finally, there must be a concerted effort to continue the fight against tax evasion and avoidance. The OECD delivered to the G20 Finance Ministers in Cairns, Australia, on 20th September, a package of actions covering 7 key areas of international tax rules to combat Base Erosion and Profit Shifting (BEPS). 44 OECD and non-OECD G20 countries have worked together on an equal footing and agreed by consensus on all of these measures; while 80 developing countries have provided input through regular consultation. These measures will help reduce tax treaty abuse, better deal with the fiscal implications of the digital economy, and neutralise hybrid mismatches. The OECD is now looking forward to forthcoming discussions on the feasibility of a multinational instrument to streamline implementation. Earlier this year, the OECD also released a single common standard of Automatic Exchange of Information in tax matters: More than 65 countries have now committed to the implementation of this standard which will help countries fight tax evasion, with more than 40 having committed to a specific and ambitious timetable leading to the first automatic information exchanges in 2017.

ⁱ OECD Economic Outlook, Volume 2014 Issue 1

ⁱⁱ OECD, OECD Employment Outlook 2014, p.11

ⁱⁱⁱ OECD, OECD Employment Outlook 2014, p.27

^{iv} OECD, OECD Employment Outlook 2014, p.13

^v New Sources of Growth: Knowledge Based Capital

^{vi} OECD@100: Policies for a shifting world