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Joint meetings of the ITUC and the TUAC with the IMF and the WB

Economic Briefing

Paris, 19 February 2020

Ahead of the Joint meetings of the International Trade Union Confederation and the Trade Union Advisory Committee to the OECD with the International Monetary Fund and World Bank (2-3 March 2020), the TUAC is sharing the following economic briefing to the attention of the participants attending the event.

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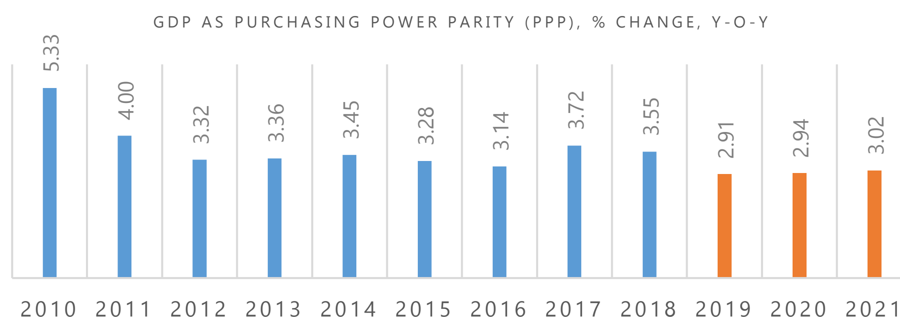
No wind in the sails: meagre economic growth further slowing down

Recent forecasts leave little margin for optimism: economic growth has been subdued over the past year, and will remain modest in the period to come. According to the latest OECD revision, world gross domestic product (GDP) growth halted at 2.9% in 2019, the lowest since the global financial crisis, and it is predicted to remain at around 3% for the next two years (Figure 1). Figures indicate a marked decrease in manufacturing and industrial output reflecting greater economic uncertainty linked to international trade tensions, particularly between the USA and China, and a weakening global demand.

Figure 1 –World GDP growth rates, 2010-2021



Source: TUAC elaboration based on the OECD Economic Outlook 106 database.

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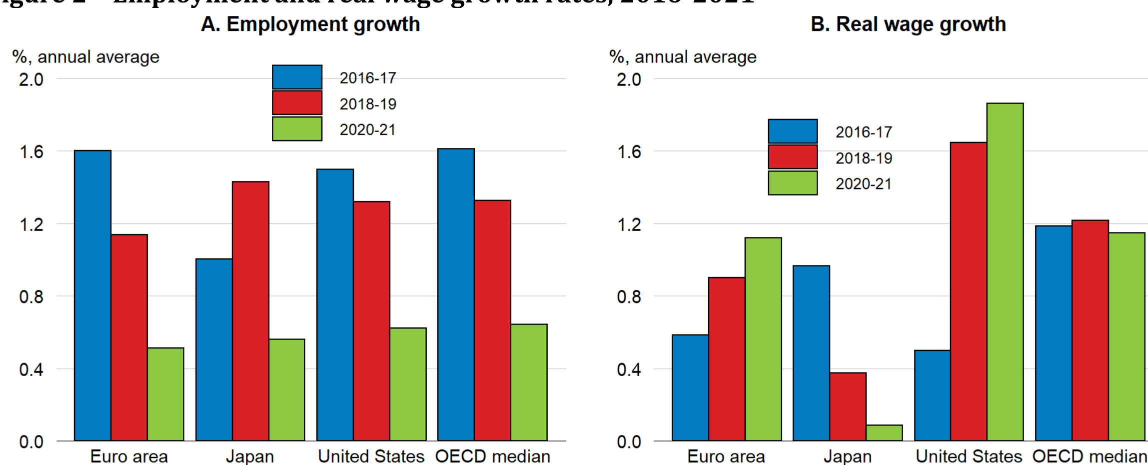
There are concurring causes that explain the feeble economic performance at the global level. Some are structural, such as the falling labour share that depresses aggregate demand; others result from recent geopolitical uncertainty, mounting protectionism, the slowdown of the Chinese economy and financial markets unpredictability.

Compressed wages and poor quality of new jobs affect growth prospects

The engines of growth are stalled. Private consumption (household spending) has been fairly supportive of economic growth, thanks to the recovery in employment rates in the OECD-area and a recent pick-up in real wages in selected countries, but diminishing economic activity and investment are expected to affect negatively future prospects (Figure 2). In addition to that, the employment increase has not been matched with better job quality, as for example documented for the United States, where the average market income for the bottom 50% of working-age adults has fallen by 6.2% since 1980 (Hawell and Kalleberg, 2019).

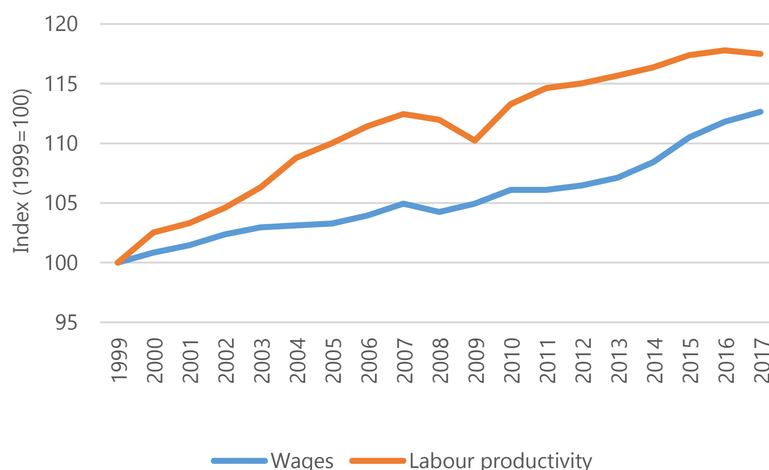
Figure 2 – Employment and real wage growth rates, 2016-2021



Note: Based on a sample of 33 OECD economies. Real wages are measured as compensation per employee deflated by the private consumption deflator.
Source: OECD Economic Outlook 106 database; and OECD calculations.

Regarding wage increases, it is also important to remind that in the longer period, between 1999 and 2017, real wages at the world level have just grown by 2.2%, down to 1.4% if China is not taken into account (International Labour Organization, 2018). Therefore labour productivity rose faster than real wages over the entire period, particularly in high-income countries (Figure 3). This resulted in a falling labour income share in world GDP by 2.5%, from 53.8% in 2004 to 51.3% in 2017.

Figure 3 - Trends in average real wages and labour productivity in high-income countries, 1999–2017

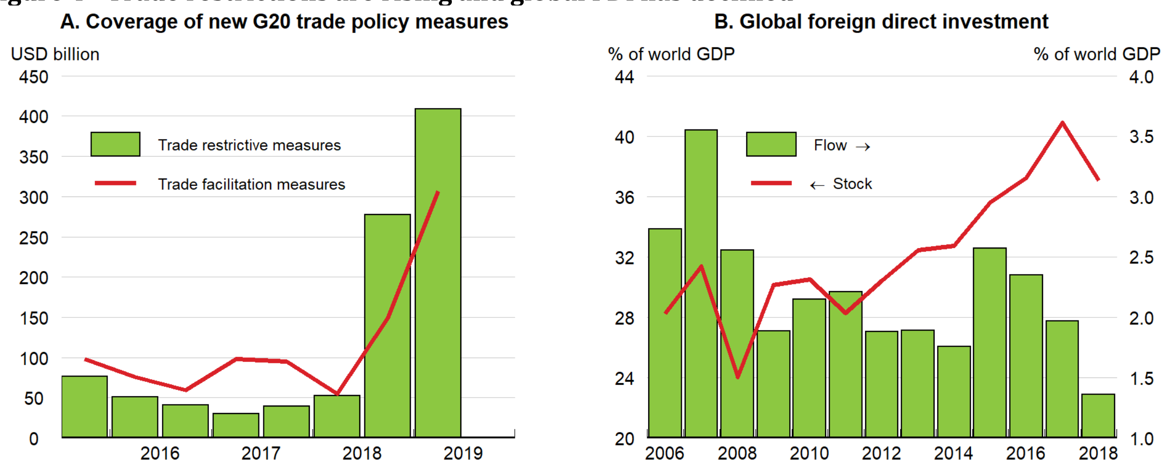


Source: ILO (2018), Global Wage Report 2018/19 database and ILO calculations.

Further escalation in trade and investment policy restrictions

Current geopolitical tensions contribute to dismal economic prospects. An agreement between the US and China was reached on 15 January 2020, which momentarily paused the introduction of additional US tariffs to Chinese goods. However, the risk of further escalation in the US-China trade war persists, with potential negative spillover effects from goods to services trade and increased barriers to investment on both sides. Another factor of concern are trade tensions between the United States and the European Union, with the potential introduction of tariffs on imports of European automotive and aeronautic products to the US. In parallel to rising trade tensions, a fall in foreign direct investment (FDI) flows was registered (Figure 4).

Figure 4 - Trade restrictions are rising and global FDI has declined

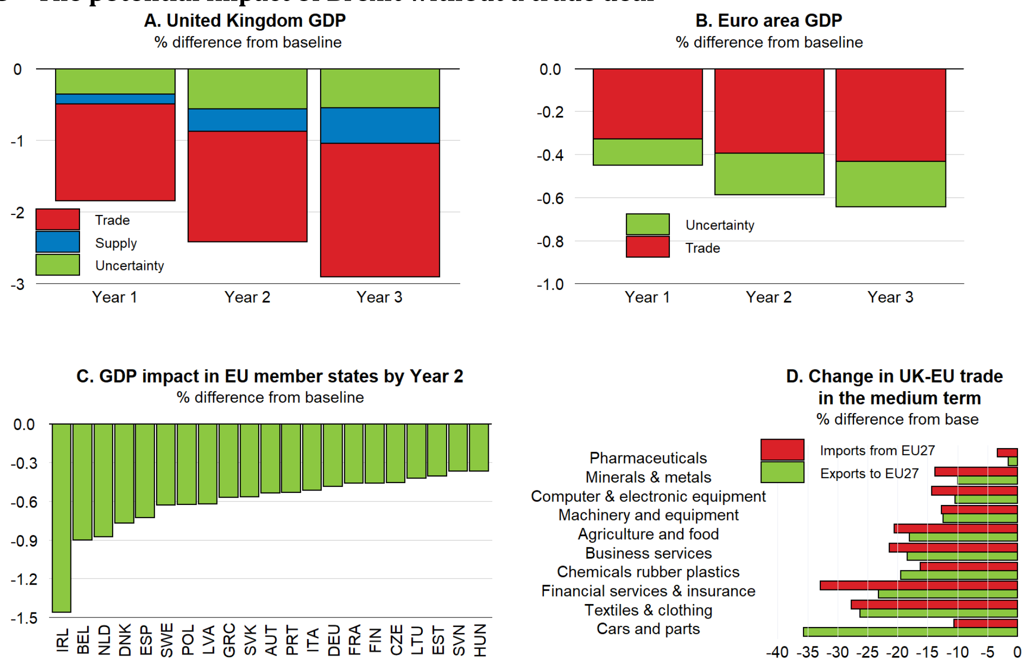


Note: Data in Panel A are two period moving averages. These figures are estimates and represent the trade coverage of the new measures undertaken in each reporting period. Coverage is defined as the annual imports of the product concerned from economies affected by these new measures. Data in Panel B are averages of inward and outward FDI flows and stocks.
Source: OECD-UNCTAD-WTO (2019), 21st Report on G20 Trade and Investment Measures, June 2019; OECD (2019), FDI in Figures, October 2019; and OECD calculations.

Uncertainty related to future agreements between the United Kingdom and the European Union

While the Withdrawal Agreement Bill is expected to pass the vote of the British Parliament at the time of this note, the terms of a free trade agreement between the UK and the EU are not clear, despite both parties announced the intention to reach one by the end of 2020. The OECD estimates the potential cost to GDP of the Brexit to be especially large for the UK (up to 2.5% of GDP in 2020), and negative for the EU (over 0.5% of GDP), in the absence of mitigating policy responses by the respective parties (Figure 5).

Figure 5 – The potential impact of Brexit without a trade deal

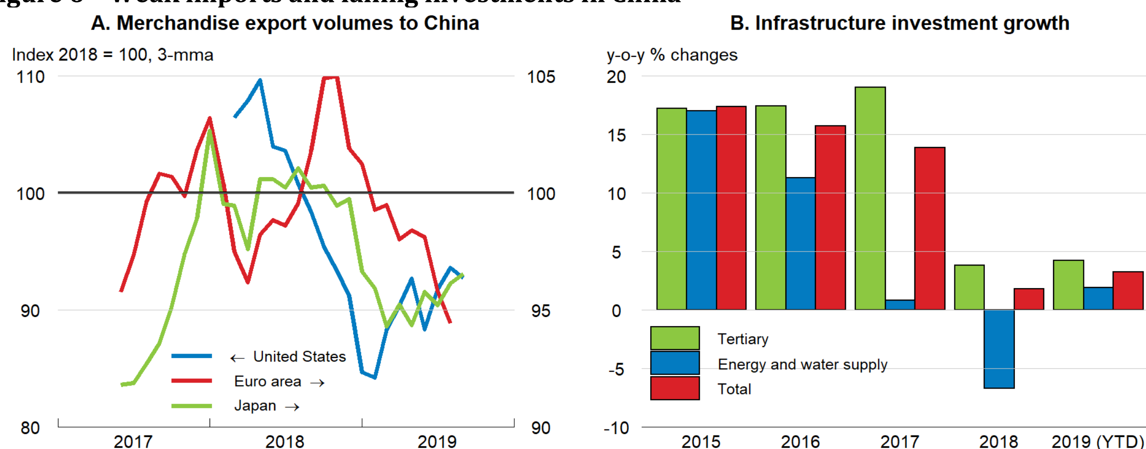


Note: See OECD Economic Outlook 106, p. 32, for underlying model assumptions
Source: OECD Economic Outlook 106 database; and OECD calculations.

Deterioration of Chinese macroeconomic performance

Chinese imports from the rest of the world have fallen sharply in 2018, together with output (Figure 6). While these dynamics mirror larger structural changes in the Chinese economy (an aging population, the rebalancing between investments and consumption, shifting preferences from imported to domestically-produced brands, first measures to contain environmental damage), they might also hint to potential ineffectiveness of fiscal measures announced by the Chinese government in support of the economy. According to OECD predictions, a more serious slowdown in Chinese domestic consumption could have serious repercussions on global GDP growth prospects.

Figure 6 – Weak imports and falling investments in China



Source: Eurostat; Bank of Japan; Census Bureau; Bureau of Labor Statistics; National Bureau of Statistics of China; and OECD calculations.

Turbulences on financial markets

Long-term US bond yields have fallen below the short-term bond yields level, which has historically happened only in times prior to a recession, possibly hinting to an incoming one. The deteriorating quality of corporate bonds due to the record levels of private corporate debt, particularly in the United States, makes financial markets more fragile even in the event of a modest shock. The risk of increased volatility and unpredictable financial losses in the case of quick changes in market sentiment make predictions harder and the risk of distresses on financial markets more concrete, with potentially explosive outcomes.

The policy response

To offset these risks, the OECD is calling for policies that «strengthen growth, stimulate aggregate demand and boost potential growth». When translating these into concrete policy recommendations, though, the OECD goes back to business as usual: strengthening and liberalising market competition, investing in workers skills, streamlining tax and transfer policies, improving quality of infrastructure, supporting innovation and shifting taxation (whether from labour or profits remains unfortunately unclear) towards property, consumption and environmental taxation.

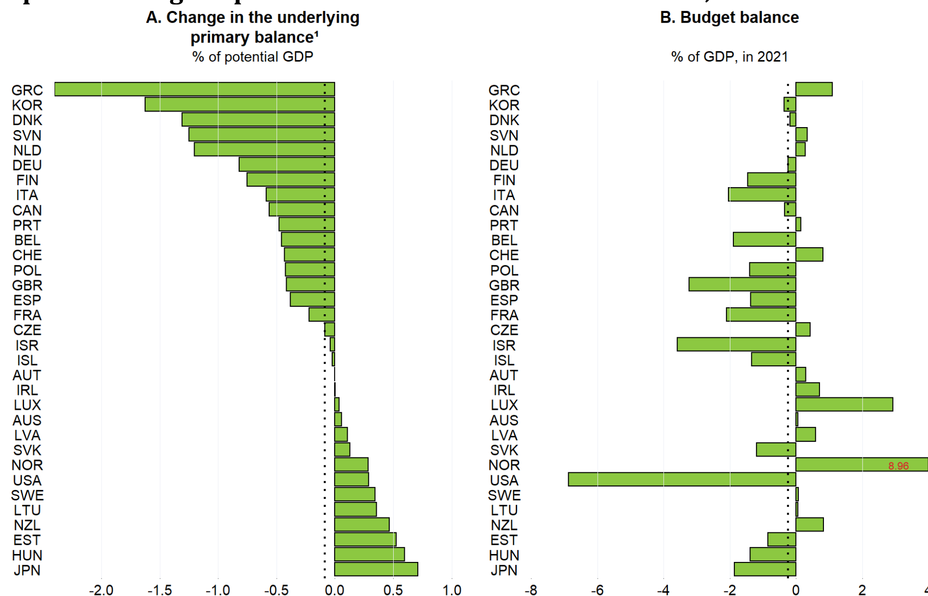
The call for strengthened fiscal policy intervention

While monetary policy is predicted to remain accommodative in most OECD countries, particularly in Europe and the US, inflation remains below target levels in most OECD countries: from 0.5% in Japan, to 1% in the euro area and 1.7% in the United States. With interest rates already at their minimum, central banks have little margin for additional manoeuvre. On the contrary, governments are extremely conservative in expanding their fiscal policies, missing the opportunity to boost economic growth.

Indeed, the OECD urges its members to strengthen counter-cyclical policy measures. In particular, the Organisation stresses the need to complement existing monetary policies,

which have in several cases exhausted their capacity by reaching zero or negative policy interest rates, with pro-active fiscal intervention, to boost expenditure in the short-run and investment in the medium-to-long-run. While such efforts would prove most effective if pursued at the international level, by co-ordinating monetary and fiscal interventions across countries, there is little illusion that this will happen soon. Predicted fiscal policy stances in the OECD area will remain overall neutral in the 2019-2021 period (Figure 7), with particularly cautious countries like Germany, the Netherlands and Sweden that could afford an extra 0.5% of GDP public stimulus without increasing their gross debt.

Figure 7 – Expected change in public balances across OECD countries, 2019-2021



Note: Vertical lines show medians;
1. Change between 2019 and 2021.
Source: OECD Economic Outlook 106 database; and OECD calculations.

Against such baseline scenario, the OECD Economic Outlook simulates the impact of a hypothetical fiscal stimulus in the euro area close to 4% of GDP over a five-year period. It finds that a combined monetary-fiscal intervention would prove stronger in the short period, and more effective in the long run, thanks to increased productivity and public capital stock, than relying solely on monetary policy, i.e. quantitative easing. Such fiscal stimulus would not only contribute to reduce the debt to GDP ratio, but also the absolute debt stock in the euro area, thanks to boosted GDP performance (OECD, 2019).

The longer term policy reform agenda

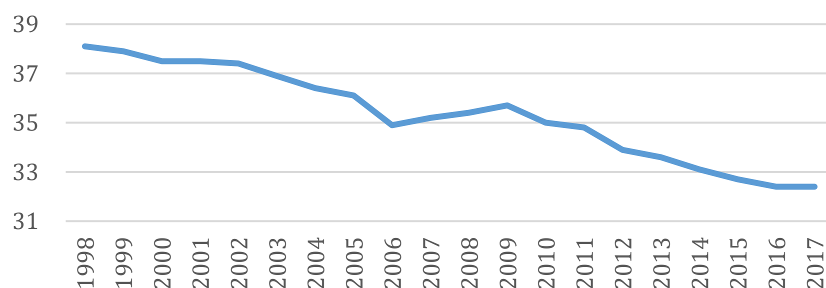
Summing up, the inability of governments to take action on coordinated fiscal policy, combined with recent geopolitical tensions, increase systemic uncertainty and negatively affect economic growth. Global aggregate demand is stagnating because of increasing wealth and income concentration and private debt accumulation. The recovery in employment levels and competitiveness, spurred from the degradation of labour rights and the compression of wages, exacerbates the sustainability of a prolonged economic recovery.

Employment and wages are not the residual of increased productivity and firms' profitability, rather a major driver of consumption and, thus, business sentiment, investment and growth. Yet and again, structural reforms in the past decades have mostly been one-directional and intended to fix the supply, with the idea that boosting competition would increase production, which would in turn create its own demand. When employment legislation is discussed, it is only to the detriment of job security and the workers' rights ("flexibilisation"), prominently seen as a cost to the single employers.

Policy-makers have failed to notice the fallacy of composition that manifests when employment and wages get compressed, resulting in a fall of productivity and the net reduction of consumption capacity in the economy. Recent findings suggest that the decline in unionisation rates is accountable for the drop in productivity, because it incentivises less efficient firms competing solely on labour cost to cut wages rather than invest in increasing productivity (Dosi et al., 2020). At the micro level, this leads to the high dispersion of productivity among firms, while on the macro level it is responsible for the fall in productivity, wage share and further drop of unionisation rates: according to OECD estimates, collective bargaining coverage in OECD countries has dropped from 38% in 1998 to 32% in 2017 (Figure 8).

Trade union density has also fallen, with most prominent cases being Sweden (from 92% to 65% of the total employed), the Czech Republic (from 32% to 12%), Hungary (from 27% to 8%), Finland (from 78% to 60%), Ireland (from 40% to 24%), but also Germany (from 25% to 17%), the Netherlands (from 24% to 17%), the United Kingdom (from 30% to 23%), Japan (from 22% to 17%) and the United States (from 13% to 10%).

Figure 8 – Collective bargaining coverage in OECD countries, % of total employees, 1998-2017



Source: TUAC elaboration based on OECD (2020), Trade Unions and Collective Bargaining database.

On the contrary, when policy makers in most developed economies think of efficient measures in support of labour creation, these are primarily confined to skilling, i.e. reforming education curricula to match the needs of the labour market, and re-skilling, e.g. active labour market policies for the unemployed. Matching labour supply and demand does not automatically guarantee equal levels of income and job security, unless complemented with employment protection legislation, minimum wages and strengthened collective bargaining systems.

The time is overdue to re-think national and international priorities for enhancing growth, having in mind that most developed economies are wage- rather than profit-led. As such, more space must be allowed for public expenditure (including addressing the challenges of the not-so-distant future, from demographic aging to climate change,

industrial transition and digitalisation) and private consumption, through higher wages and more certainty about future employment prospects.

References

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