Trade Union
Advisory Committee
to the OECD
Commission
syndicale consultative
auprès de l'OCDE
TUAC

TUAC Comments to the OECD Interim Economic Assessment

Coronavirus, but not only

Paris, 4 March 2020

On 2 March 2020, the OECD published its Interim Economic Assessment, under the title *Coronavirus: The World Economy at Risk*. The assessment focuses on the impact of the SARS-CoV-2 virus (commonly referred to as coronavirus) on the global economy.

Key findings

Following the impact of the coronavirus, the OECD has substantially cut economic growth forecasts between 0.5 and 1.5 percentage points:

- In a "best case" scenario, the epidemic peaks in China in the first half of 2020 and is contained to current levels elsewhere; global GDP growth projections shift from 2.9%, as anticipated in the November 2019 *Economic Outlook*, down to 2.4%.
- In the "worst case" scenario, the coronavirus outbreak does not stop and spreads throughout Asia-Pacific, Europe and North America, halving growth prospects for 2020 from 2.9% to 1.5% only.

The OECD report urges governments to act immediately, including a much needed and welcome call to support well-resourced public health systems. The report further reiterates previous recommendations to maintain accommodative monetary and supportive fiscal policies, which can mitigate, though not fully offset, the disruptions caused by the spreading virus.

In light of the OECD revised estimates, the situation is concerning. The diffusion of the coronavirus has very likely not reached its plateau as of early March 2020, which makes the OECD best-case scenario of 2.4% GDP growth in the year less realistic. Second, the current epidemiological emergency comes on top of an already weakened global economy and an economic regime that a decade since the global financial crisis is not able to deliver sustained and continued growth.

The TUAC has been advocating for a long time for increased fiscal expenditure, along with labour-friendly policies to strengthen wages and household income growth. This is the most effective way to combat economic stagnation and create a buffer against unexpected shocks, like the one induced by the coronavirus. Expanding fiscal expenditure only after the crisis hit could be too little, too late.

Finally, the OECD calls for co-ordinated monetary and fiscal stimulus at the G20 level. The L20 has been long advocating for the G20 to refocus on its historical mandate «to prevent and resolve international financial crises» and support «stable and sustainable world economic growth that benefits all» (G20, 2008). As the world economy is, yet again, on the edge of global recession, far more action from the G20 and G7 fora is expected. Co-ordinated multilateral action represents the best response to the global economic weakening: this includes health policies, containment and mitigation measures, support to low-income economies, joint and co-ordinated raise of fiscal interventions to restore confidence and support household incomes.

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A supply-side shock magnified by world dependence on China…

The coronavirus is a textbook example of what economists refer to as an "external shock": an unexpected factor outside the standard economic model, which could not be foreseen and that affects economic activity and projections.

China, where the coronavirus originated, is paying the highest price in terms of human health and lives, as well as economic output. The necessary containment efforts put in place by the Chinese government impact the ability of labour and factory production to restart across the country. The diffusion of global supply chains makes the world much more inter-connected than ever before, with China representing the global factory for most sectors and links in the chain. Even if the coronavirus proves milder in its impact on human health than previous contagions, such as the SARS in 2003, its effect on the global economy could be far stronger.

According to the OECD Trade in Value Added database (TiVA), in 2015 39% of value added in imports across OECD countries originated from China, compared to 31% in 2005. The percentage jumps to 50% when considering manufacturing only, up from 40% a decade earlier. Disruptions in any and multiple supply chains because of reduced activity in China will therefore represent a serious challenge to production elsewhere.

Services are affected as well: travel restrictions and bans take their toll. Chinese tourists represent 10% of all cross-border visitors, up to 25% and more in Japan, Korea and other Asian economies. Tourism accounts for 4.5% of GDP and 7% of employment in the OECD area, therefore a severe drop in tourism income will have repercussions on the whole economy.

…but the economy was weak way before the virus hit

Being a supply-side shock, many would argue, there is little governments can do but manage public health and try to preserve people's confidence in spending, while supply chains recover, production re-starts and the world economy recovers to where it was before the coronavirus hit. However, where was the economy before January 2020?

At the end of 2019, the OECD revised world GDP growth to its lowest levels since the global financial crisis of 2008 (OECD, 2019). According to it, GDP growth halted at 2.9% in 2019, and was predicted to remain at around 3% for 2020 and 2021. Figures indicated a marked decrease in manufacturing and industrial output and reflected greater economic uncertainty linked to international trade tensions, particularly between the USA and China, and a weakening global demand.

As reminded by the news these days, the most exposed people to the coronavirus are the most vulnerable ones, the elderly and the sick. Similarly, the *economic* impact of the virus can only be greater when affecting an already weakened economy: it will take only a few tenths of a percentage point to lead a subdued rate of economic growth into recession, compared to a healthy and robust economic system.

The revised OECD best-case scenario sets GDP growth at 2.4% in 2020. Traditionally, the International Monetary Fund defines a global growth rate below 2.5% as recession. This definition might be controversial, and should be updated keeping into account inflation and population growth levels, but it is indeed telling of the dire situation we are currently experiencing. In addition, as bad as it looks, such projection is based on the assumption that the coronavirus will remain contained at current diffusion levels and not spread to more economies than the few ones currently hit – a scenario that seems to be challenged in the news by the hour.

A crisis of supply, exposing a more structural issue of demand

The engines of growth have stalled because household income has been compressed for too long. The OECD (2020) hints to a stagnating industrial production in late 2019, and feeble consumer spending despite rises in employment levels. Indeed, recent employment gains have not been matched with good 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).

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 (ILO, 2018). Therefore, labour productivity rose faster than real wages over the entire period, particularly in high-income countries (Figure 1). This resulted in a cut of the labour income share in world GDP of 2.5%, from 53.8% in 2004 to 51.3% in 2017.

Figure 1 - 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.

Policies to restore growth

The OECD calls for a number of solutions to weak economic performance, close to mainstream supply-side economic policy: strengthening and liberalising market competition, investing in workers skills, streamlining tax and transfer policies, improving quality of infrastructure, supporting innovation and shifting taxation towards property, consumption and environmental taxation (OECD, 2019). The latest Interim Assessment reiterates many of these, while stressing the relevance of fiscal intervention in countries most affected by the coronavirus.

The call for maintaining an accommodative monetary policy

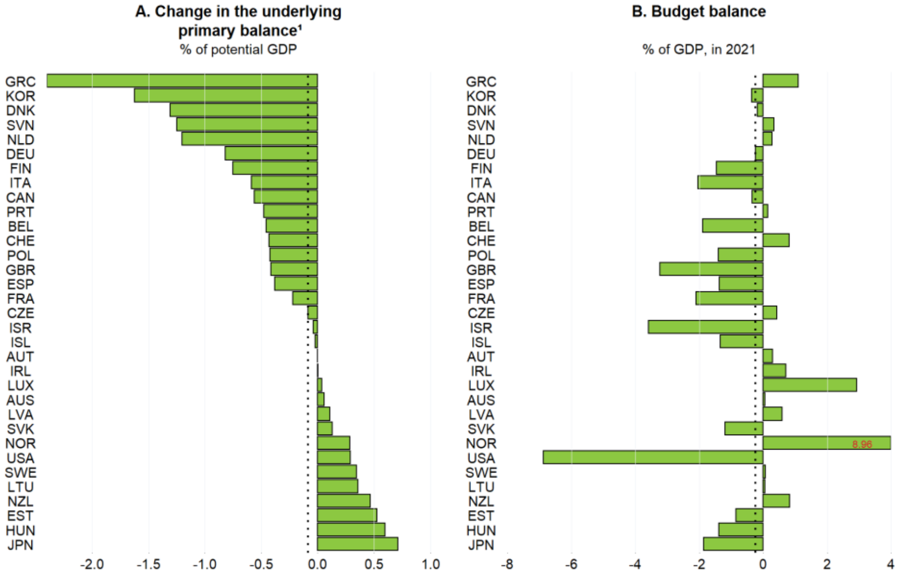
The OECD re-states that it is essential to maintain supportive monetary policies to ensure long-term low interest rates (OECD, 2020). In fact, long-term interest rates are already falling, since investors tend to privilege long-term government bonds given short-term risks associated with the coronavirus. 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.

Furthermore, the liquidity injected in the system by the continuous expansionary monetary policy is leading to a dramatic accumulation of riskier corporate debt. According to a recent OECD publication, the world's non-financial corporations borrowed USD 2.1 trillion in the form of corporate bonds in 2019 only (Çelik et al., 2020). More than 50% of new investment bonds issued between 2016 and 2019 have a medium BBB rating, characterised by lower overall credit quality, higher payback requirements, longer maturities and inferior covenant protection. This can potentially represent a significant threat to global financial stability, as was the case before the 2008 financial crisis.

The call for strengthened fiscal policy intervention

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 2), 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 (OECD, 2019).

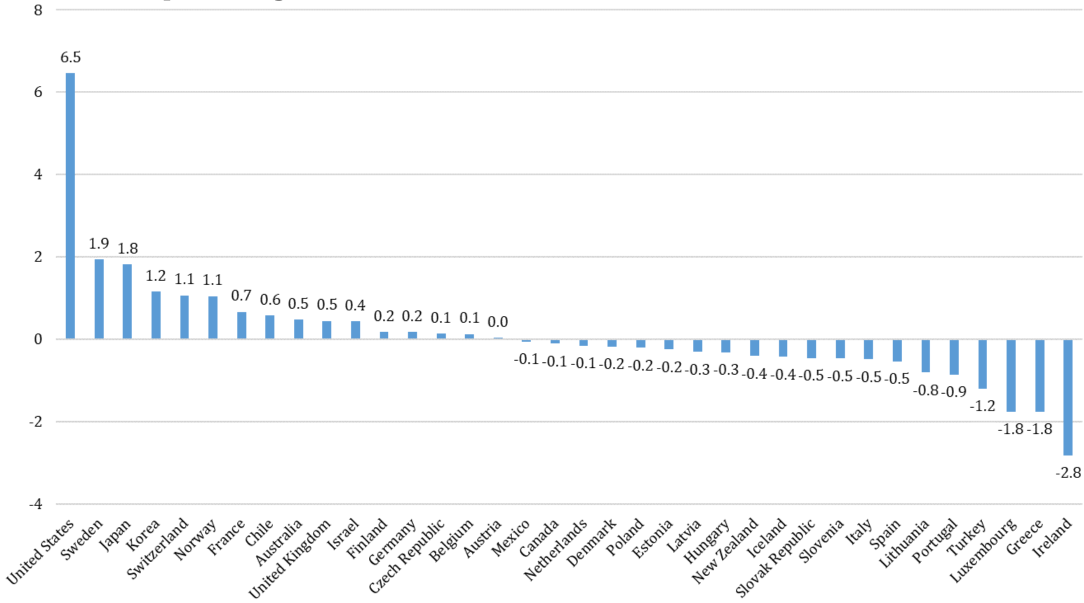
Figure 2 – Expected change in public balances across OECD countries, 2019-2021



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

In light of the coronavirus emergency, the OECD invites countries to provide fiscal support for health services, including staffing and testing facilities, and all necessary prevention, containment and mitigation measures. While this sounds as a sensible advice, it must be reminded that health systems are not accordions that can be expanded and compressed as pleases: increasing the workforce, infrastructure and general capacity of public health systems requires time. On the contrary, overly cautious fiscal measures implemented across many OECD countries after the global financial crisis, particularly in the European Union, affected health expenditure. OECD statistics show that government health expenditure in terms of GDP basically stagnated between 2009 and 2018 (Figure 3), increasing by just 0.1%, closer to -0.1% when excluding the USA Patient Protection and Affordable Care Act.

Figure 3 – Government/compulsory schemes current expenditure on health across OECD countries, difference in GDP percentage between 2018 and 2009



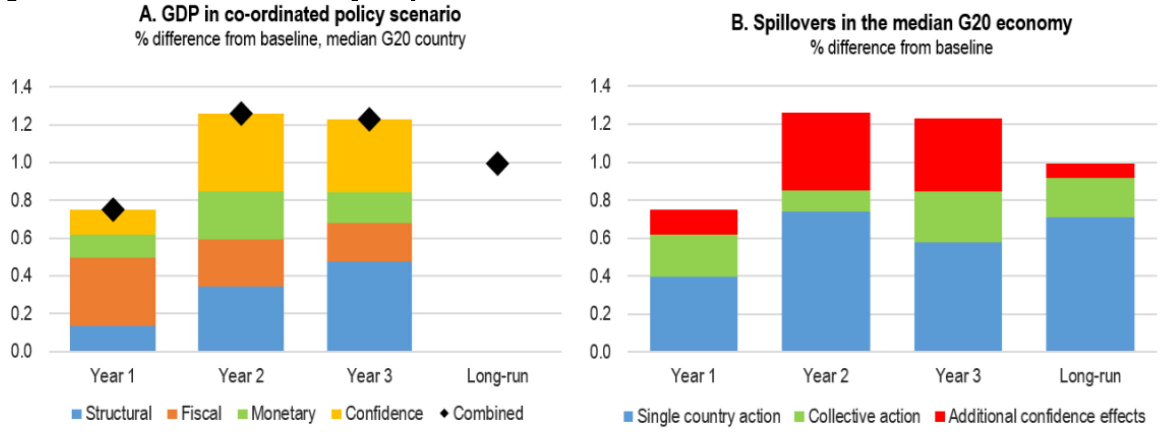
Source: TUAC calculations based on the OECD Health statistics database

The necessity of globally co-ordinated and more forceful actions

Fiscal stimulus is most effective if conducted simultaneously by a number of countries, benefitting from spillover effects at the international level. The OECD (2019) 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.

The latest Assessment reiterates the call for co-ordinated policy actions across major economies to stimulate activity, beyond European borders (OECD, 2020). A simulated impact of fiscal, monetary and structural measures in all G20 countries, supported via a 0.5% debt-financed fiscal easing for three consecutive years, would raise GDP growth by around 0.8% in the first year and 1.3% in the second year. This represents a stronger outcome than if any of the G20 countries were to undertake the same type of measures independently (Figure 4).

Figure 4 – The benefits of G20 policy co-ordination



Note: Scenario in Panel A with all G20 economies simultaneously undertaking changes to fiscal, monetary and structural policies. Countries undertake additional debt-financed public expenditure of 0.5% of GDP for three years, monetary policy becomes more accommodative in economies with policy interest rates above zero (all countries excluding Japan and those in the euro area) and productivity-enhancing structural reforms occur raising TFP by 1% after five years. Confidence is modelled by a 50 basis point reduction in investment and equity risk premia for two years, which slowly fades.
Source: OECD calculations using the NiGEM macroeconomic model, in (OECD, 2020).

The longer term policy reform agenda

Summing up, the inability of governments to take action on coordinated fiscal policy, combined with recent economic and geopolitical tensions, increase systemic uncertainty and negatively affect 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. The first effects of the coronavirus hint to the precarious position of the global economic system after a decade of stagnation and persistent compression of aggregate demand.

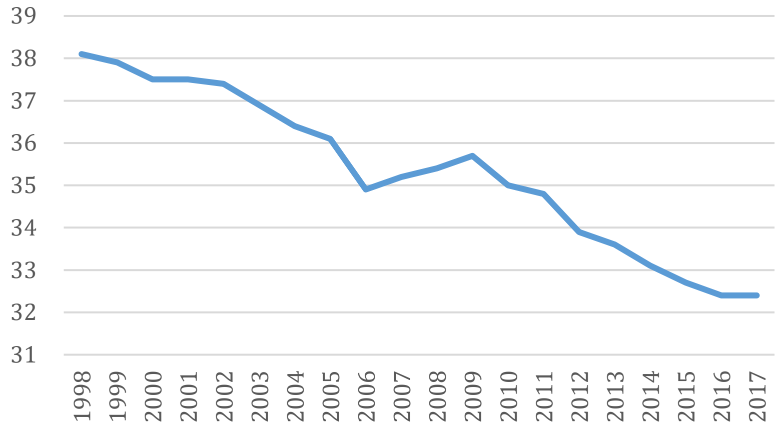
Employment and wages are not the residual of increased productivity and firms' profitability, rather a major driver of consumption and, thus, business sentiment, investment and growth. Yet and again, structural reforms in the past decades have mostly been one-directional and intended to fix the supply, 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.

In order to recover employment levels, policy makers primarily engage in skilling policies, 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.

Governments have failed to notice the fallacy of composition that manifests when employment and wages are 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 5).

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



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

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 granted 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.

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Commentaires du TUAC sur l'évaluation économique intermédiaire de l'OCDE

Coronavirus, mais pas seulement

Paris, 4 mars 2020

(traduction française du résumé)

Le 2 mars 2020, l'OCDE a publié son Évaluation économique intermédiaire, sous le titre *Coronavirus: l'économie mondiale en danger*. L'évaluation se concentre sur l'impact du virus du SRAS-CoV-2 (communément appelé coronavirus) sur l'économie mondiale.

Principales conclusions

Suite à l'impact du coronavirus, l'OCDE a considérablement réduit les prévisions de croissance économique entre 0,5 et 1,5 point de pourcentage:

- Dans le «meilleur des cas», l'épidémie culmine en Chine au premier semestre 2020 et se maintient aux niveaux actuels ailleurs; les projections de croissance du PIB mondial passent de 2,9%, comme prévu dans les *Perspectives économiques* de novembre 2019, à 2,4%.
- Dans le «pire des cas», l'épidémie de coronavirus ne s'arrête pas et se propage à travers l'Asie-Pacifique, l'Europe et l'Amérique du Nord, réduisant de moitié les perspectives de croissance pour 2020 de 2,9% à 1,5% seulement.

Le rapport de l'OCDE exhorte les gouvernements à agir, y compris un appel (nécessaire et bienvenu) pour soutenir des systèmes de santé publique dotés de ressources suffisantes. Le rapport réitère en outre les recommandations passées de l'OCDE en matière de politiques monétaires (maintenir une politique accommodantes) et budgétaires favorables, qui peuvent atténuer, mais pas entièrement compenser les perturbations causées par le virus de propagation.

Au vu des estimations révisées de l'OCDE, la situation est préoccupante. La diffusion du coronavirus n'a probablement pas atteint son plateau début mars 2020, ce qui rend le scénario de l'OCDE le plus favorable d'une croissance du PIB de 2,4% cette année moins réaliste. Deuxièmement, l'urgence épidémiologique actuelle vient s'ajouter à une économie mondiale déjà affaiblie et à un système économique qui, dix ans après la crise financière mondiale, n'est toujours pas en mesure de générer une croissance soutenue et continue.

Le TUAC plaide depuis longtemps pour une véritable relance budgétaire coordonnées, ainsi que des politiques favorables à l'emploi pour renforcer les salaires et le revenu des ménages. Une relance qui sera plus efficace pour lutter contre la stagnation économique et anticiper les chocs externes, comme celui induit par le coronavirus. La relance budgétaire une fois la crise éclatée, pourrait être trop faible, trop tard.

Enfin, l'OCDE appelle à une relance monétaire et budgétaire coordonnée au niveau du G20. Le L20 plaide depuis longtemps pour que le G20 se recentre sur son mandat historique : «prévenir et résoudre les crises financières internationales» et soutenir «une croissance économique mondiale stable et durable qui profite à tous». Alors que l'économie mondiale est, encore une fois, au bord de la récession mondiale, une réaction des forums du G20 et du G7 est attendus. Une action multilatérale coordonnée représente la meilleure réponse à l'affaiblissement économique mondial: outre une action déterminante en matière de santé, il nous faut un soutien aux économies à faible revenu, et donc une augmentation conjointe et coordonnée des relances budgétaires pour restaurer la confiance et soutenir les revenus des ménages.