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OECD Economic Outlook December 2020: the light at the end of the tunnel?

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In its last edition for 2020 of the Economic Outlook, the OECD provides growth forecasts and policy recommendations for exiting, eventually, the COVID-19 crisis.

Executive summary

- Year 2020 will end with a global GDP fall of -4.2%. The global average masks important discrepancies among countries and it remains highly uncertain, until a vaccine confirmation and distribution on large scale become effective. Global unemployment will remain persistently larger than prior to COVID-19, at about 7% for the next three years, almost 2% higher than in 2019.
- In its policy response, the OECD endorses prolonged fiscal and monetary policy in support of the economy, amid the worst crisis in peacetime history.
- Beyond the immediate support measures to the economy, the OECD report suggests addressing fiscal policy towards education, health, digital and physical infrastructure.
- On employment and labour market specifically, the focus is on skills and vocational education and training, on active labour market policies and on reducing "barriers to labour mobility", such as occupational licensing and housing market rigidities. In short, workers hit by the crisis are asked to educate themselves and to move for new jobs. Little is said about the need for employers to improve employment protection, nor about collective bargaining.
- Increasing access to skills is of course much relevant, but definitely insufficient to tackle the enormous social and economic challenge of the immediate future, once most support measures to firms and workers phase out. On that, the Economic Outlook misses again the opportunity to mention the role of social dialogue, labour institutions and collective bargaining in guaranteeing fair and decent jobs in the face of rising unemployment, job inequality and labour market concentration.
- Furthermore, the analysis does not mention the prolonged compression of wages and their decoupling from productivity levels, which has been a normal for the past twenty and more years, with negative effects on aggregate demand, hence economic growth. Additional labour market liberalisation would arguably intensify, rather than solve, these issues.
- In discussing inflation and monetary policy, the Economic Outlook flags three major mega-trends as the cause of stagnant prices: globalisation, technological

progress and market concentration; reduction of intermediaries in the retail sector and lower mark-ups; saturation of demand for durable goods in the face of large production capacity.

- Again, the OECD fails to acknowledge the central role of wages in driving price expectations. Under-consumption in many economies is not the result of "saturated" demand, on the contrary it stems from rising income inequality and budgetary constraints, which negatively affect aggregate demand.
- Among else, the Economic Outlook delves into the rising insolvency risk and debt overhang in the corporate sector, suggesting viable ways for the public sector to support private companies, including equity and quasi-equity financing solutions. Yet, it does not raise the important topic of conditionalities that should be attached to such forms of public support to the business sector. Contrary to the idea of neutrality at all costs, the state could well have a steering role in boosting firms' investment decisions and addressing it towards strategic directions, from digitalisation to the green economy.

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Economic projections

According to the latest OECD revision, 2020 will end with a recession of -4.2% of world GDP, followed by a rebound in 2021 that will almost offset the fall. Yet, the global average masks important discrepancies among countries. Particularly, China (+1.8% in 2020 and +8% in 2021) and G20 countries (-3.8% in 2020 and +4.7% in 2021) will witness a relatively stronger recovery in the coming year. On the contrary, developed countries will need at least two years to regain pre-crisis levels. OECD countries, marking a -3.7% GDP drop in 2020, will grow by 3.3% in 2021, but it is the Euro area to be of most concern, with a considerable drop of -7.5% of GDP in 2020 and a mild 3.6% recovery in 2021. Similarly, Japan is registering a GDP erosion of -5.3% in 2020 and a 2.3% growth in 2021. Global unemployment will be substantially larger than prior to COVID-19, at about 7% for the next three years, almost 2% higher than in 2019. The negative toll on unemployment is particularly hard in the United States and Canada, given the high degree of flexibility on their labour markets.

This forecast remains highly uncertain, as it rests on the assumption of an effective and widely available coronavirus vaccine by the end of 2021, locally containable virus outbreaks in the next six to nine months and prolonged monetary and fiscal support.

Fiscal policy and the OECD's recipe for growth

According to the OECD, "extensive fiscal support is pushing public debt levels to record highs, but the cost of debt is at record lows. A striking feature of the outlook is the absence of correlation between the extent of fiscal support and the resulting economic performance, suggesting not all measures have been used wisely." This consideration sounds somewhat unfair, as fiscal packages introduce at the height of the pandemic were mainly addressed at cautioning the negative blow of the COVID-19 pandemic on health and the economy, especially in those countries that introduced severe lockdown measures. In the absence of such interventions, the impact of the crisis would had been much stronger, especially on vulnerable categories and workers who benefitted from extended short-time work schemes and other social benefits.

Nonetheless, it is certainly important to funnel fiscal support from here onwards "into stronger and better economic growth". For the OECD, this means education, health, physical and digital infrastructure. The TUAC agrees these to be strategic sectors to guarantee competitiveness in the long run. However, it might not be sufficient to address urgent challenges posed by COVID-19 and the disruptions that it will cause in many economies.

In this sense, the global economy has entered a downward spiral that market forces alone can hardly overturn. Some of its elements are well present in the OECD Economic Outlook:

- subdued aggregate demand, due to uncertainty about future employment perspectives and lockdown measures, which depresses demand for goods and services (particularly in sectors like travel, food, the entertainment industry);
- low private investment, following feeble demand expectations but also increased corporate debt leverage;
- persistently low inflation, which again drags investments down;
- lack of international co-operation; and
- uncertainty for open emerging economies heavily reliant on tourism and exports.

The conclusion is that "the median advanced and emerging-market economy could have lost the equivalent of 4 to 5 years of per capita real income growth by 2022. Initial estimates of potential output growth in the aftermath of the pandemic also highlight the likelihood of permanent costs from the outbreak, with potential output growth in the OECD economies projected to slow to just over 1¼ per cent per annum in 2021-22, some ½ percentage point weaker than immediately prior to the crisis."

In this context, the appropriate role for the public hand might be larger than simply fine-tuning the economy between one business cycle and the next, while delving into "structural reforms". According to the latest IMF Fiscal Monitor, published in October 2020, "scaling up of quality public investment can have a powerful impact on employment and activity, crowd in private investment, and absorb excess private savings without causing a rise in borrowing costs."[i]

The OECD does endorse prolonged fiscal intervention in the face of COVID-19, but does not say enough about the state's entrepreneurial role in construction, housing, manufacturing and other sectors where the public intervention could drive investments, boost private firms' confidence and create direct and indirect employment.

The labour market

The Economic Outlook highlights how the crisis and containment measures led to an important drop in hours worked, with differences across sectors but particularly hitting low-skill workers and workers at the bottom of the earning distribution. Yet, the report is not very original when it comes to suggesting effective labour market policies. Basic recommendations include better skills (enhanced vocational education and training), active labour market policies and reduced barriers to labour mobility, such as occupational licensing and housing market rigidities.

Skills (up-skilling, re-skilling) are a favourite suggestion of the OECD, but will not be sufficient to guarantee a smooth transition for the tens of millions of displaced workers due to COVID-19. In the face of a considerable and prolonged reduction in economic activity, drop in consumption and investment, the total number of jobs will shrink, as it did after the Global Financial Crisis, when it took a decade to recover pre-crisis employment levels. According to the ILO, cumulate working-hour losses in the second quarter of 2020 equalled 495 million full-time jobs worldwide and a 10.5% loss in labour income in the first three quarters of 2020, worth USD 3.5 trillion.[ii]

While workers at the margins are hit the hardest, the OECD should also remind that it is the entire middle-class to be inexorably eroding and shifting downwards, in the face of rising inequalities that pre-date COVID-19.[iii] The Economic Outlook misses the opportunity to mention the role of social dialogue, labour institutions and collective bargaining in guaranteeing fair and decent jobs, in the face of rising unemployment, job inequality and labour market concentration. More, it does not mention the dismantling of employment protection systems. Nor it addresses the prolonged compression of wages and their decoupling from productivity levels, which has been a normal for the past twenty years at least, with negative effects on aggregate demand, hence economic growth. Additional labour market liberalisation and supply-side policies would arguably intensify, rather than solve, these issues.

Monetary policy

As in the case of fiscal policy, the OECD is clearly in favour of sustained monetary intervention in support of economic activity. Yet, it points to the important question of (lack of) inflation. In particular, while low interest rates benefit fiscal sustainability in the short to medium run, they pose concrete challenges for investment, pension and insurance funds.

The Economic Outlook dedicates an entire section to the topic of changing monetary policy frameworks in the face of a new normal, characterised by low inflation and low employment. Comparing countries, it highlights recent developments in the US Federal

Reserve mandate, which recently set a 2% average inflation target, next to achieving maximum employment levels. It is surprising that the OECD does not recognise that the European Central Bank does also have, next to price stability, a broader social objective, as set in Title I, Article 3 of the Trade on the Functioning of the European Union. While this might not have been applied in practice, there are signs that the ECB actively works not only towards price stability, but also towards the broader integrity of the Euro area.

More importantly, the Economic Outlook flags three major mega-trends as the cause of stagnant prices: globalisation, technological progress and market concentration; reduction of intermediaries in the retail sector and lower mark-ups; saturation of demand for durable goods in the face of large production capacity.

Again, the OECD fails to acknowledge the central role of wages in driving price expectations. Under-consumption in many economies is not the result of "saturated" demand and production overcapacity, on the contrary it stems from rising income inequality and budgetary constraints for the average household. The wage-price pass-through could be an important driver for inflation at a time of considerable demand shock, as documented, among others, by the ECB.[iv] Yet, rising non-standard forms of employment, unemployment, stagnating household incomes and the un-doing of labour market institutions make such recovery difficult, with negative implications for the entire economy.

Insolvency and debt overhang

Another focus of the Economic Outlook is the rising insolvency risk for viable firms under COVID-19, and the nature of public support to private companies. Assuming a decline in profits of 40% to 50% compared to the previous year and depending on the severity of the COVID-19 recession, the OECD estimates that between 7.3% and 9.1% of otherwise viable firms, accounting for between 6.2% and 7.7% of employment, would become distressed. Reduced equity would increase leverage ratios and the ability to service increased debt levels, while negatively affecting investment perspectives (-2%).

Therefore, rather than increasing debt, the OECD advocates forms of equity and quasi-equity public financing as a preferable solution. While the analysis delves deeper into the subject, it does not mention the need for conditionalities to apply to public support for private firms. Yet, this is not only a legitimate moral request when it comes to investing public money into private ventures, but could also represent a good opportunity to boost investment, steering it towards strategic goals, from the digitalisation and technological uptake, especially of smaller firms, to the green economy.[v]

Conclusion

The Economic Outlook raises the alarm about the consequences of COVID-19 and long-lasting scars to the economy, particularly for most vulnerable categories (youth, low-skill and low-paid workers). In response, it encourages governments to maintain expansionary fiscal and monetary policy, while gradually re-targeting broad fiscal measures in strategic directions such as education, health and infrastructure.

While the general analysis is correct, the OECD report maintains the traditional focus on structural reforms, skills and labour market rigidities as the main focus for policy intervention. Amid what might turn to be the worst employment crisis in modern history, the Economic Outlook relies solely on supply-side measures and the ability of the market to re-deploy resources effectively. It fails to mention the erosion of labour institutions, rising number of non-standard workers and compressed wages as key drivers for the macroeconomic fragility that pre-dates COVID-19, making the recovery more complex. Thus, rather than "turning hope into reality", in the absence of better social dialogue, collective bargaining and strengthened employment protection system it is reasonable to expect a feeble economic recovery in the years to come, similarly to what happened after the Global Financial Crisis of 2008.

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[i] IMF (2020), *Fiscal Monitor: Policies for the Recovery*. Washington, October, https://www.imf.org/en/Publications/FM/Issues/2020/09/30/october-2020-fiscal-monitor.

[ii] ILO (2020), *ILO Monitor: COVID-19 and the world of work. Sixth edition*, https://www.ilo.org/wcmsp5/groups/public/@dgreports/@dcomm/documents/briefingnote/wcms_755910.pdf.

[iii] OECD (2019), *Under Pressure: The Squeezed Middle Class*, OECD Publishing, Paris, https://doi.org/10.1787/689afed1-en.

[iv] Bobeica, E., Ciccarelli, M., and I. Vansteenkiste (2019), "The link between labor cost and price inflation in the euro area", *ECB Working Paper Series No. 2235*, https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2235~69b97077ff.en.pdf.

[v] TUAC (2020), *No string attached? COVID-19 public support to businesses under scrutiny*, https://tuac.org/news/no-strings-attached-a-trade-union-review-of-oecd-findings-on-covid-19-public-support-measures-to-private-businesses/.