For the Record

The OECD Economic Outlook

Highlights

The convergence of cyclical conditions in the OECD area is likely to continue in the coming year, with robust and sustainable growth in the United States and a continuation of the expansions in Japan and Europe, following a pause in 1996 (Table 1). At the same time, substantial output gaps suggest that the risk of a resurgence of inflation will remain low in Japan and continental Europe, at least for the next year or two (Table 2). And in Europe, high unemployment will remain a major problem (Table 3). In some other countries, particularly the United States, where unemployment is low, and the United Kingdom, where it has fallen significantly, there may be a risk of inflationary pressures although, as yet, there are no convincing indications that inflation is rising. Short-term macro-economic policy requirements for achieving and enhancing non-inflationary growth therefore differ according to country- or region-specific situations. In a nutshell, judicious use of monetary policy, together with credible, sustained fiscal consolidation over time without heavy concentration of restraint in a short span of time would contribute to faster growth of output and employment without compromising the objectives of inflation control.[1]

In the face of this short-term situation, growth of output and living standards over the 1990s is likely to fall well short of post-war achievements in all major OECD areas. Improving on this relatively weak performance would raise material living standards as well as provide the resources to meet long-standing social goals, including an acceptable distribution of income, the elimination of poverty and the protection of the most vulnerable members of society; such resources will be required all the more as populations age.

Considerable progress has been made in reducing fiscal deficits in most OECD countries, with the notable exception of Japan, where output is still depressed (Table 4). But ratios of public debt to GDP remain high and pressures on public finances will intensify over the coming decades with population aging. Continuing the process of fiscal consolidation over the medium-term is thus the key macro-economic policy challenge facing virtually all OECD countries. Cutting fiscal deficits further to stop and reverse the build-up of public debt that has occurred in the past two decades would reduce long-term real interest rates and stimulate productive investment, growth and employment opportunities.

Enhancing the credibility of medium-term fiscal consolidation programmes could pay immediate dividends in terms of economic performance, thereby reducing the short-term risks attached to deficit reduction. If financial markets, businesses and households are assured that necessary fiscal corrections will actually be carried out, the short-term adverse aggregate-demand effects of consolidation would be mitigated. Financial markets, anticipating that the pressures associated with the requirements of government financing will recede, will tend to reduce real interest rates, even in the short run, thereby stimulating private-sector investment. Confidence that the long-term benefits of fiscal consolidation would be forthcoming would further raise investment demand and, in addition, it could boost household consumption. Some of these effects appear to have operated in Denmark and Ireland, both of which experienced sharp reductions in fiscal deficits in the late 1980s along with buoyant private-sector domestic demand. In the past year, the progress made in reducing deficits in Italy

1. ***OECD Economic Outlook***, *No. 60, OECD Publications, Paris, 1996.*

Table 1

Growth of Real GDP in the OECD Area

%

	Share in total OECD	Change from previous year			
	1991	1995	1996	1997	1998
United States	36.36	2.0	*2.4*	*2.2*	*2.0*
Japan	14.56	0.9	*3.6*	*1.6*	*3.7*
Germany	8.34	1.9	*1.1*	*2.2*	*2.6*
France	6.37	2.2	*1.3*	*2.5*	*2.6*
Italy	5.97	3.0	*0.8*	*1.2*	*2.1*
United Kingdom	5.54	2.4	*2.4*	*3.3*	*3.0*
Canada	3.21	2.3	*1.5*	*3.3*	*3.3*
Total/average of above 7 countries	80.35	1.9	*2.2*	*2.1*	*2.6*
Australia	1.70	3.2	*4.1*	*3.3*	*3.0*
Austria	0.83	1.8	*1.1*	*1.4*	*2.3*
Belgium	1.06	1.9	*1.3*	*2.2*	*2.6*
Czech Republic	0.55	4.8	*4.8*	*4.6*	*5.3*
Denmark	0.55	2.8	*1.9*	*2.9*	*3.1*
Finland	0.48	4.2	*2.5*	*3.5*	*3.6*
Greece	0.62	2.0	*2.2*	*2.5*	*2.8*
Hungary	0.38	1.5	*0.5*	*1.7*	*3.2*
Iceland	0.03	2.1	*5.4*	*3.3*	*2.9*
Ireland	0.26	10.3	*7.0*	*6.2*	*6.8*
Luxembourg	0.06	3.7	*2.4*	*3.1*	*3.2*
Mexico	2.70	–6.9	*4.0*	*5.0*	*4.5*
Netherlands	1.52	2.1	*2.7*	*2.7*	*3.0*
New Zealand	0.28	1.9	*1.2*	*2.9*	*2.9*
Norway	0.49	3.3	*5.1*	*3.0*	*2.3*
Poland	0.99	7.0	*5.5*	*5.0*	*5.0*
Portugal	0.62	2.4	*2.6*	*2.9*	*3.2*
Spain	3.04	2.8	*2.1*	*2.7*	*3.0*
Sweden	0.89	3.6	*1.7*	*2.2*	*2.1*
Switzerland	0.91	0.1	*–0.3*	*0.8*	*2.0*
Turkey	1.69	7.3	*7.5*	*5.7*	*5.0*
Total/average of above 21 countries	19.65	2.0	*3.2*	*3.4*	*3.5*
EU	36.15	2.5	*1.6*	*2.4*	*2.7*
Total OECD	100.00	2.0	*2.4*	*2.4*	*2.7*

Figures in *italics* are provisional.

has helped to reduce interest-rate differentials significantly vis-à-vis Germany. Moreover, in the absence of inflationary pressures, credible fiscal-consolidation plans can allow a cut in policy-controlled interest rates to offset the negative short-run demand effect of fiscal consolidation without compromising the primary goal of achieving and maintaining price stability. In such a context, it should be possible to lower short rates without increasing pressure on long-term interest rates which would be detrimental to growth and increase the cost of deficit financing.

To be credible, such programmes should be concrete, sustainable and transparent. Building a fiscal programme on concrete measures would mitigate the risk that timely action on taxes or expenditures might not be taken and, consequently, that fiscal targets will not be met. The sustainability of a fiscal programme depends to a large extent on the 'quality' of the measures actually taken. Where tax burdens are already high – as is the case in many European countries – further substantial increases in taxes necessary to close budget deficits may be too costly in terms of the economic distortions they generate, as reflected in poor labour-market or productivity performance. In such cases, expenditure reductions may prove to be economically more efficient and, therefore, sustainable in the long run. Reliance on one-off measures, such as capital transfers from publicly owned enterprises, or on measures that may have to be reversed, including some public-sector wage freezes and deferrals of public investments, only delay the necessity of more fundamental fiscal adjustments. The consolidation process can be made more transparent by establishing overall fiscal principles and goals, as well as by clarifying the budget concepts relevant to those goals, the economic assumptions that underlie medium-term budget forecasts and government accounts. In some cases, binding fiscal rules may reinforce credibility, although in many cases they may prove difficult to enforce and there is a risk that the loss in flexibility of fiscal policy could at times aggravate economic cycles.

Sustainable improvement in economic performance will, however, involve much more than fiscal consolidation: it will also require that structural reforms be undertaken on a wide front in order to increase the efficiency of the use of scarce resources as well as to enhance innovativeness and the adaptability of OECD economies to changes brought about by globalisation and new technologies. In product markets, preliminary research suggests that there could be significant long-term gains to regulatory reform in both Japan and continental Europe, where regulation is more pervasive and reforms have not yet been as comprehensive as those in the United States and the United Kingdom (although the research suggests that the latter would also benefit substantially from further reform). The

Table 2

Private Consumption Deflators in the OECD Area

%

	Change from previous year			
	1995	*1996*	*1997*	*1998*
United States	2.4	*2.1*	*2.2*	*2.3*
Japan	–0.5	*0.0*	*0.6*	*0.3*
Germany	1.9	*1.7*	*1.5*	*1.5*
France	1.6	*1.8*	*1.3*	*1.2*
Italy	5.7	*4.2*	*2.5*	*2.2*
United Kingdom	2.6	*2.6*	*2.5*	*2.3*
Canada	1.6	*1.4*	*1.3*	*1.4*
Average of above 7 countries	2.0	*1.8*	*1.8*	*1.7*
Australia	2.5	*2.1*	*2.5*	*2.8*
Austria	2.3	*1.9*	*1.8*	*1.7*
Belgium	1.6	*2.0*	*1.9*	*1.7*
Czech Republic	9.1	*9.1*	*8.5*	*7.5*
Denmark	2.1	*2.1*	*2.5*	*2.8*
Finland	0.2	*0.6*	*1.7*	*2.1*
Greece	9.3	*8.6*	*7.2*	*6.0*
Hungary	26.4	*23.0*	*19.0*	*16.0*
Iceland	1.8	*2.3*	*2.8*	*3.4*
Ireland	2.0	*1.8*	*2.0*	*2.1*
Luxembourg	0.7	*1.4*	*1.8*	*2.0*
Mexico	39.1	*35.0*	*17.0*	*10.0*
Netherlands	0.9	*1.7*	*2.1*	*2.2*
New Zealand	2.3	*1.9*	*1.6*	*1.3*
Norway	2.4	*1.3*	*2.5*	*2.4*
Poland	27.8	*19.6*	*14.9*	*11.6*
Portugal	4.1	*3.3*	*2.6*	*2.4*
Spain	4.7	*3.6*	*2.9*	*2.5*
Sweden	2.4	*1.5*	*2.1*	*2.2*
Switzerland	1.3	*0.7*	*1.2*	*1.4*
Turkey	94.6	*78.0*	*73.0*	*65.0*
Average of above 21 countries	17.7	*14.9*	*11.7*	*9.7*
EU	3.0	*2.6*	*2.1*	*2.0*
OECD *less* high-inflation countries[1]	2.1	*1.9*	*1.9*	*1.8*
Total OECD	5.1	*4.4*	*3.7*	*3.3*

Figures in *italics* are provisional.

1. High-inflation countries are defined as those which have had 10% or more inflation in terms of the GDP deflator on average during the 1990s on the basis of historical data. Consequently, the Czech Republic, Greece, Hungary, Mexico, Poland, Portugal and Turkey are excluded from the aggregate.

blueprint laid out in the *OECD Jobs Study*[2] provides the best way forward for sustainably reducing unemployment and raising employment: a stable macro-economic framework, measures to ensure the re-integration of the unemployed, especially youth and the long-term unemployed, into the labour market, reductions in disincentives to hire and work, policies to increase skills and deregulation to increase flexibility and dynamism.

In addition to the challenge of raising longer-term growth, the governments of OECD countries are also facing the problems associated with poverty and exclusion. In many countries, particularly in Europe, these problems have been aggravated by the rise in structural and long-term unemployment during the past 25 years. In other countries, particularly the United States and the United Kingdom but also some continental European countries, there are concerns that rising wage and income inequality have had adverse social consequences. These issues are linked to fiscal reform. The increase in government outlays in the past 30 years has, in most countries, been driven by rising social expenditures, including, in many countries, those related to rising unemployment. While these programmes have alleviated poverty, some of them have distorted economic incentives, particularly in labour-markets, reducing employment and output. Conversely, pressures for fiscal consolidation and labour and product market reforms have raised concerns about the public sector's ability to deal with social problems.

The relationship between growth and inequality is complex, and the usual assumption of a 'trade-off' between the two is not necessarily correct. A concern about the deregulation of labour markets is that higher employment will come at the expense of a wider distribution of wage rates. However, increased employment – in terms of both jobs and hours worked – that would result from appropriate labour-market reforms might more than offset a wider wage-rate distribution. Evidence from the United States and a few European countries, for which comparable data on labour-earnings distributions are available, suggests that labour-market reforms do not have to increase labour-earnings inequality even if they increase wage-rate inequality. But it is important to emphasise that changes in the distribution of labour earnings may not be reflected in distributions of disposable income, which depend also on the redistributive effects of taxes and transfers, and are central to the questions of poverty and the distribution of economic resources.

More generally, the relationship between equity and growth will depend on the specific policies in place. For example, redistributive measures that heavily distort economic decisions are likely to blunt growth, whereas those that encourage the formation of human capital are likely to raise growth and, if

*2. **The OECD Jobs Study: Facts, Analysis, Strategies**, OECD Publications, Paris, 1994; **The OECD Jobs Study: Evidence and Explanations**, OECD Publications, Paris, 1994; **The OECD Jobs Study: Investment, Productivity and Employment**, OECD Publications, Paris, 1995; **The OECD Jobs Strategy: Technology, Productivity and Job Creation**, OECD Publications, Paris, 1996; **The OECD Job Strategy: Enhancing the Effectiveness of Active Labour Market Policies**, OECD Publications, Paris, 1996; **The OECD Jobs Strategy: Pushing Ahead with the Strategy**, OECD Publications, Paris, 1996.*

Table 3
Unemployment in the OECD Area[1]

	Thousands	*% of labour force*			
	1993	*1995*	*1996*	*1997*	*1998*
United States[2]	8,927	5.6	*5.4*	*5.4*	*5.5*
Japan	1,645	3.2	*3.3*	*3.2*	*3.1*
Germany	3,419	9.4	*10.3*	*10.4*	*10.1*
France	2,946	11.7	*12.4*	*12.5*	*12.1*
Italy	2,335	12.0	*12.2*	*12.2*	*11.8*
United Kingdom	2,884	8.2	*7.6*	*7.4*	*7.0*
Canada	1,649	9.5	*9.6*	*9.4*	*9.2*
Total/average of above 7 countries	23,804	6.9	*6.9*	*6.9*	*6.8*
Australia	944	8.6	*8.4*	*8.1*	*8.0*
Austria	222	5.9	*6.2*	*6.5*	*6.4*
Belgium	512	13.0	*12.9*	*12.6*	*12.3*
Czech Republic	184	3.0	*3.0*	*3.6*	*4.1*
Denmark	349	10.3	*8.9*	*8.6*	*8.4*
Finland	444	17.2	*16.4*	*15.5*	*14.5*
Greece	398	10.0	*10.1*	*10.3*	*10.4*
Hungary	519	10.3	*10.6*	*10.6*	*10.5*
Iceland	6	5.0	*4.3*	*3.9*	*3.7*
Ireland	219	12.2	*12.0*	*11.8*	*11.6*
Luxembourg	4	3.0	*3.1*	*3.0*	*2.9*
Mexico[3]	516	6.3	*6.0*	*5.5*	*5.3*
Netherlands	415	7.1	*6.6*	*6.2*	*5.8*
New Zealand	157	6.3	*6.2*	*6.0*	*6.1*
Norway	127	4.9	*4.2*	*3.9*	*3.6*
Poland	2,427	13.3	*12.5*	*12.0*	*11.4*
Portugal	248	7.2	*7.2*	*7.1*	*6.9*
Spain	3,481	23.3	*22.7*	*22.4*	*21.7*
Sweden	356	7.7	*7.9*	*7.4*	*7.2*
Switzerland	179	4.2	*4.6*	*4.8*	*4.5*
Turkey[4]	1,601	7.5	*7.2*	*6.8*	*6.8*
Total/average of above 21 countries	13,307	10.3	*9.9*	*9.7*	*9.4*
EU	18,232	11.2	*11.4*	*11.3*	*10.9*
Total OECD	37,112	7.8	*7.8*	*7.7*	*7.5*

Figures in *italics* are provisional.

1. Commonly used definitions.
2. Break in series from January 1994.
3. Figures based on the national survey of urban employment.
4. Important revisions to data.

Table 4
Current Balances in the OECD Area
% of GDP

	1995	*1996*	*1997*	*1998*
United States	–2.0	*–2.1*	*–2.0*	*–2.0*
Japan	2.2	*1.4*	*1.4*	*1.5*
Germany	–0.7	*–0.7*	*–0.2*	*0.0*
France	1.1	*1.3*	*1.5*	*1.6*
Italy	2.5	*3.5*	*4.2*	*4.3*
United Kingdom	–0.4	*–0.1*	*–0.2*	*–0.5*
Canada	–1.5	*0.0*	*0.4*	*0.4*
Average of above 7 countries	–0.1	*–0.3*	*–0.1*	*–0.1*
Australia	–5.4	*–4.1*	*–4.0*	*–3.9*
Austria	–2.0	*–1.7*	*–1.3*	*–0.9*
Belgium/ Luxembourg	5.6	*6.1*	*6.0*	*6.1*
Czech Republic	–4.1	*–5.8*	*–5.4*	*–4.9*
Denmark	0.9	*1.0*	*1.1*	*1.1*
Finland	4.5	*3.3*	*3.5*	*3.9*
Greece	–2.5	*–3.5*	*–3.5*	*–3.7*
Hungary	–5.6	*–3.9*	*–3.3*	*–3.2*
Iceland	0.8	*–2.1*	*–3.0*	*–1.5*
Ireland	2.2	*1.9*	*1.8*	*1.7*
Mexico	–0.2	*0.0*	*–1.2*	*–2.2*
Netherlands	4.4	*4.4*	*4.5*	*4.6*
New Zealand	–4.4	*–3.9*	*–4.5*	*–4.5*
Norway	3.0	*6.1*	*6.3*	*6.0*
Poland	–2.0	*–5.2*	*–5.7*	*–6.6*
Portugal	–0.2	*–0.4*	*–0.4*	*–0.5*
Spain	0.2	*0.1*	*–0.1*	*–0.2*
Sweden	2.0	*3.0*	*3.9*	*4.5*
Switzerland	6.6	*6.6*	*6.2*	*6.0*
Turkey	–1.6	*–2.9*	*–3.6*	*–4.0*
Average of above 21 countries	0.9	*0.8*	*0.7*	*0.6*
EU	0.7	*1.0*	*1.3*	*1.3*
Total OECD	0.0	*–0.1*	*0.0*	*0.1*

Figures in *italics* are provisional.

directed at those who now have relatively little human capital, narrow the distribution of income. Currently, however, much of the discussion in this area remains theoretical, and there is an urgent requirement to proceed to empirical analysis of specific policy options.

Finding ways to manage the social aspects of fiscal and structural reform is thus one of the most important challenges facing policy-makers. Effective design of policies and programmes can thus minimise the potential conflict among policy objectives, but some trade-offs will certainly remain. The weight given to competing considerations must ultimately be determined by the political process. In practice, decision-making is complicated by the difficulties of quantifying the trade-offs involved, as well as by the well known political problems in overcoming the opposition of entrenched interests, particularly in situations where the government has only a small majority, is split owing to a coalition or to internal divisions or faces a difficult election in the near future. Such considerations point to the importance of objective analysis of economic-policy choices, including their social consequences, and of clearly communicating the results in order the better to inform public debate. Moreover, the equity concerns raised by fundamental structural reform are real. Dealing with them in a constructive way will be easier if the public decision-making process is – and is seen to be – transparent and fair.

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