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C/M(99)12/ANN 2

UNCLASSIFIED / NON CLASSIFIE

CONSEIL AU NIVEAU DES MINISTRES

26-27 MAI 1999

POINT 3

CROISSANCE, EMPLOI ET COHESION SOCIALE – PRIORITES POUR LES GOUVERNEMENTS DES PAYS DE L'OCDE

NORVEGE

Déclaration

Mr. Gudmund RESTAD
Minister of Finance

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COUNCIL AT MINISTERIAL LEVEL

26-27 MAY 1999

ITEM 3

GROWTH, EMPLOYMENT AND SOCIAL COHESION – POLICY PRIORITIES FOR OECD GOVERNMENTS

NORWAY

Statement

Mr. Gudmund RESTAD
Minister of Finance

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Norwegian Minister of Finance

MEETING OF OECD COUNCIL AT MINISTERIAL LEVEL

26TH AND 27TH MAY 1999

I should like to complement the Secretariat for the quality of the documentation circulated to this meeting. I shall briefly address some of the issues for discussion suggested in "**BUILDING MOMENTUM FOR GLOBAL GROWTH AND SOCIAL PROGRESS INTO THE NEW MILLENNIUM** (C/MIN(99)2) item 3.

Item 3. Growth, Employment and Social Cohesion - Policy Priorities for OECD Governments

During the last year or two, with crisis situations in much of emerging Asia and Latin America, the United States has constituted the main dynamic element of the global economy. Japan has been in recession and economic growth in Europe has been moderate and weakening. Looking ahead, given present high levels of capacity utilisation in the United States, the expansion in that economy seems bound to slow down. Outside the OECD area, the situation in most emerging economies may be stabilising but there is little prospect of strong growth in the near future. It is therefore desirable and generally agreed that Japan and Europe should provide more of an engine for the global economy than they have done in the recent period. A main question is what Japan and European countries can do to improve performance both in the short and longer run.

- The United States

Most observers, including the OECD, agree on the broad outlook for the US economy: a fairly marked weakening of growth in the course of 1999 and 2000, continued moderate inflation, and growing external deficit. But given the imbalances that have developed, there is uncertainty about the form that the transition to slower growth will take: a main problem for policy is to ensure that it will take the form of a soft rather than a hard landing.

Is there a need for a tightening of monetary policy?

It cannot be excluded that, once again, the economy will surprise the world and refuse to slow down. Given the strong rise in fixed investment in recent years associated with rapid technical progress, the diffusion of high technology equipment throughout the economy, and stronger competition in product markets, there may be more spare capacity than traditional measures of labour market tightness would suggest.

Nevertheless, even assuming a fair degree of improvement of the supply-side of the economy, there would seem to be risks of overheating and stronger rise in prices unless the economy slows down.

- Unemployment has fallen to around 4 ¼ per cent of the labour force, the lowest for almost 30 years, and well below the structural rate of unemployment generally estimated to lie between 5 and 6 per cent.
- Some of the surprises in economic performance in recent years, such as declining non-wage labour costs and falling import prices due to lower world commodity prices and the appreciation of the dollar, are likely to be temporary; oil prices have already turned up.
- The strong rise in the consumer price index in April (a month-to-month rate of 0,7 per cent) may be a warning of stronger inflationary pressures. The rise in the core rate, excluding oil prices, was 0,4 per cent, the highest for four years.

Moreover, imbalances have emerged that represent a potential source of instability for both the United States and the world economy.

- Equity prices are unusually high in relation to company earnings, with the average price-earnings ratio of the shares included in the Standard and Poor index presently running at around 35, which is an all time high.
- There has been a persistent tendency for domestic savings to fall short of domestic investment, reflected in a long-standing and - during the 1990s - growing current external deficit which, according to the OECD, may rise to around 3 ½ per cent of GDP in the present year.

As suggested at the recent meeting of the Economic Policy Committee, the economy may be in a situation of non-linear dynamics, in which small policy changes lead to disproportionate adjustments in the economy. Good policy judgement is therefore particularly important. It helps that bond rates, which serve as a built-in-stabiliser, have risen in recent months. But if higher bond rates are not sufficient to slow down the expansion - and there are few signs in that direction yet - a cautious tightening of monetary policy may well be called for.

The performance of the US economy in recent years has been truly remarkable, and there should be lessons for other countries here, particularly as far as the introduction of new technologies and the flexibility of labour and product markets are concerned. A main shortcoming, however, has been the persistent current external deficit, referred to above. A marked fall in the personal savings ratio from 5-6 per cent of GDP in the first half of the 1990s to around zero at present has contributed to the rising current external deficit. The decline in personal savings is related to the rise in the personal sector's net worth associated with the strong rise in the stock market in recent years, and it may well be that personal savings will pick up again if and when the stock market levels off or declines. Nevertheless, the personal savings ratio has traditionally been low in the United States, and there would seem good reasons to consider measures to stimulate it.

It should be noted, however, that the ***national*** savings rate has been rising in recent years: the public sector has moved into surplus, the corporate sector' savings rate has been broadly stable and, as already noted, total fixed investment has been rising strongly as a ratio of GDP.

- **Europe**

Recent European economic performance has been disappointing. The growth of activity slowed down rather sharply in the second half of 1998, led by a marked weakening of export growth but reflecting also weaker trends in domestic demand. Considerable divergence in cyclical conditions has emerged, both within the euro area and among countries not participating in the monetary union. A number of countries have continued to enjoy strong non-inflationary growth (Spain, Portugal, Ireland, Iceland) while others have slowed to below potential rates (notably Germany and Italy) or nearly stopped growing altogether (the United Kingdom). France is in an intermediate position.

The outlook points to some strengthening of activity in EU countries during the forecast period, helped by the depreciation of the euro, the highly welcomed cut in the European Central Bank's (ECBs) official interest rate by ½ percentage point to 2 ½ per cent on 8th April, and the cut in the Bank of England's intervention rate on the same day. But the recovery of activity expected by both OECD and national experts for 1999 and 2000 (about 2 per cent and 2 ½ per cent respectively) are not very impressive in terms of **recovery** rates, since economic slack is not likely to be much reduced.

It is important that Continental Europe should expand faster than during most of the 1990s so that, gradually, all those able and willing to work can earn a living. It is also important that stronger economic growth should be generated by faster growth of ***domestic demand*** so that Europe becomes more of an engine for the global economy and contributes to reducing international payments imbalances.

Fiscal policy in EU countries cannot do much to stimulate growth in the short run, given the size of actual deficits and the constraints of the Stability and Growth Pact. The NATO intervention in Yugoslavia, refugee assistance and any contributions to post-war reconstruction will have budgetary costs for many member countries, although it is too early to have even a rough idea of what they will be. On the other hand, countries experiencing excess demand or too rapid growth could usefully tighten fiscal policy, thus reducing inflationary pressures. More generally, over the longer term, improved budgetary positions are required in order to provide scope for fiscal stabilisers to fully operate in the event of a prolonged slowdown in economic activity.

The monetary stance seems now to be about right given the present outlook. But if the economic developments become weaker than expected, one could foresee that further easing would be compatible with the goal of price stability.

In Europe, the main problem consists of how to improve the functioning of labour and product markets and, thus, strengthen economic growth and the economies' ability to create employment. This is a long-standing problem and there is not much new to say about it, except that for the countries participating in the Economic and Monetary

Union the advent of the euro has accentuated this need; as the exchange rate can no longer be used to cope with cyclical or other chocks, the need for other adjustment mechanisms has increased.

Experience shows that the countries that have followed policies broadly in line with the OECD Jobs Strategy (such as New Zealand, the United Kingdom, Ireland, the Netherlands) have obtained significant improvements in the labour market, while countries that have been less active in this respect have had a poorer performance. It is a particular concern that three of the major European countries (Germany, France and Italy) have experienced high and rising actual and estimated structural unemployment rates throughout the 1990s. As these countries account for almost 60 per cent of the combined GDP of EU countries, it is an important matter for all of us that they should implement more fully the Job Study recommendations.

Japan

The situation in Japan remains extremely difficult. Activity has been falling since the second half of 1997, and there is little prospect of recovery. There are positive signs in the situation such as the rise in the stock market in recent months, the virtual disappearance of the Japanese premium, i.e. the premium that Japanese banks have to pay on loans raised in the international inter-bank market; and certain indications of better trends in industrial production and housing. The OECD, counting on a limited recovery of exports and the build-up of fiscal support through the middle of the present fiscal year (starting in April) assumes that activity will stabilise and remain about flat as from the second half of the present year, but states that the main risk is for an even weaker development. Japanese industry is burdened with an overhang of inventories, excess capacity and overmanning. The investment and employment cutbacks associated with corporate restructuring could be more severe than assumed, and higher unemployment and deepening fears over job security could lead households to increase their savings even further. Prices, particularly goods prices, are falling, and so are compensation per employee.

It adds to the difficulties that, according to the OECD, the possibilities for further macroeconomic support are now largely exhausted. Indeed, even the existing level of the structural budget deficit is not sustainable for much longer in view of the extremely rapid build-up in government debt (gross debt now exceeding 100 per cent of GDP).

The budget for the current financial year (April to March) provides important support to the economy, particularly in the first part of the year as the budget is frontloaded. This means that, unless a supplementary budget is adopted, fiscal stimulus could well turn negative next autumn.

The present difficult situation has developed in spite of the authorities, at least by now, having made very active use of available macroeconomic policy instruments. The money market rate has been reduced to close to zero and the government budget deficit is running at over 8 per cent of GDP and rising. An important part of the explanation may be that the process of policy implementation has generally been

characterised by too little too late, particularly when it comes to handling of the so-called bad loan problem and fiscal policy.
The private sector confidence has remained persistently weak, reflected inter alia in high personal savings rates and declining fixed investment. This is a major problem today. Moreover, structural reforms have been the main missing element. While certain measures have been adopted, most notably the "Big Bang" which include important steps towards liberalisation of the financial sector, the process has been slow, in great part consisting of promises for the future.

In the absence of improved confidence, particularly consumer confidence, it is hard to see how the economy will get out of its present plight. And it is hard to see that consumer confidence will improve at a time when hard-pressed enterprises are giving up the lifetime employment principle, an important social and cultural feature of the Japanese economy. But it might help, even at this late stage in the game, if the authorities in a unified front tried to present their policies in a more coherent and convincing manner.

The OECD argues that if output does not stabilise soon, then some more radically expansionary monetary actions may be required, such as for example monetisation of the fiscal deficit. Monetisation might reduce bond yields, or prevent them from rising, possibly with some positive effect on domestic demand. But supplying liquidity to the economy may only have a limited effect on the broad money supply so long as the banks remain reluctant to expand their lending due to concerns about capital adequacy and/or because private credit demand remains weak, indicating that there may be need of further measures to resolve banking sector problems.

There have been suggestions of more radical measures in Japan, including from Professor Paul Krugman of the Massachusetts Institute of Technology. He has argued strongly that the BOJ should adopt an inflationary target, i.e. create an expectation of inflation, in order to induce the private sector to spend. There may be risks involved in any such radical policy departure, and it is difficult to be sure that one sees all the implications of the change. I feel sure that the Japanese authorities explore all macroeconomic measures if the envisaged turn-around does not appear.

In any case, there is a need for more active policies to encourage structural reform, thus raising the longer term potential of the economy. In the short run, more rapid structural adjustment might add to the number of unemployed, but that is not a good reason to postpone structural reform measures even further. As argued by the OECD, the key to rapid deployment of labour from existing enterprises and any cuts in employment that will result from the fiscal consolidation will be to remove obstacles to enterprise creation in order to reverse the trend decline in the birth rate of firms. Regulatory reforms are needed to restore business dynamism. Important steps have already been taken, but implementation has been slow. A recent OECD report[1] has documented a detailed list of areas where reform needs to be vigorously pursued, including telecommunications, the electricity market, factor markets, general competition legislation and market access for foreign firms.

[1] The OECD Review of Regulatory Reform in Japan, Paris, April 1999.

- The OECD Jobs Strategy

In general, the Norwegian authorities agree with the analysis and main policy conclusions of ECO/CPE(99)7: "Policies to Create Jobs", circulated to this meeting, although it is felt that its recommendations to an even greater extent could have been adapted to the special features of individual countries. In particular, we believe that a consensus approach based on regular contacts between the authorities and the main labour market organisations may help to develop a mutual understanding of how the economy works - including the relationship between wage formation and employment. There are indications that this approach has played a role - perhaps an important role - in the favourable economic developments and reductions in unemployment in Austria, Ireland, the Netherlands and Norway in the 1990s. We believe that this approach could play a role also in other countries, and not only in small ones. It is recalled that this approach played a useful role in Western Germany in the 1960s and 1970s.

The unemployment problem is particularly serious in Europe, where much of it appears to be of a long term and structural nature. The urgency of more rapid progress in reducing it is enhanced by the likelihood that much of the social unrest and ethnic conflict that have become a recurrent feature in many European countries may well be related to the distress, loss of self-esteem and bitterness often associated with high rates of unemployment, particularly long term unemployment.

It is a striking feature that employment rates for prime-age males (25-54 years of age) are rather similar while the employment rates of the young, adult woman and older workers differ importantly and explain much of the differences in overall unemployment rates in member countries. As is the case in the United States, an economic policy aimed at strong growth and employment would also tend to include more marginal parts of the work force. It is, however, important that such general policies to reduce unemployment should be supplemented by specific measures to foster employment among the groups at the margin of the labour market. Judging from experience in OECD countries, I should like to stress three points.

- Education policies and active labour market measures are particularly important. It is a striking feature that in countries with well developed apprenticeship systems there is less mismatch between skills and requirements, and youth unemployment is relatively low. Moreover, in a world of rapid technological change, there is need for greater emphasis on life-long learning. In Norway, this issue has been the object of discussions between the government, the trade unions and the employers' organisations.
- It is important that young people and other marginal groups should get a foothold in the labour market and, thus, an opportunity to develop working habits and skills. and to move up the earnings scale.
- The evidence from Norway clearly supports OECD's recommendation that part-time work can contribute to integrate workers at the margin into the labour force. A key feature of the strong growth in employment in Norway in recent years has been the entry of "outsiders" into the labour force, notably women and young persons, and a related increase in the number of part-time workers. Thus, the widespread

use of part-time work has increased flexibility both on the supply and the demand side of the labour market. Norway has among the highest labour force participation rates for women in the OECD-area.

The Norwegian authorities agree that the OECD Jobs Strategy remains highly relevant. Experience shows that the countries that have undertaken comprehensive reforms along the lines advocated in the Strategy have been more successful in durably reducing unemployment than those that have not. We feel that the momentum of the Jobs Strategy should be maintained through continued multilateral monitoring and exertion of peer pressure at the OECD.