

Lessons for Inclusive Growth from OECD Countries

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Good morning, and thank you for the chance to speak to this distinguished audience today.

Five years ago, economic policymakers around the world were faced with one of the most tumultuous and trying periods since the 1930s.

Today, the economies of the OECD are in the best position they have been in since the crisis began. The United States economy has now grown for four straight years. The euro area has posted positive growth for three consecutive quarters, Japan has grown for five straight quarters, while Korea has had an impressive 22 consecutive quarters of growth. In fact, of the 34 OECD member states, 29 grew from the fourth quarter of 2012 to the fourth quarter of 2013, up from 20 during the preceding year.

But substantial challenges remain. The United States has seen its unemployment rate cut by more than a third from its high in 2010 but it is still unacceptably high, particularly due to long-term unemployment, which is our largest cyclical challenge. The euro area has not seen its unemployment rate meaningfully fall from its all-time high, and youth unemployment is an extremely serious issue in a number of countries. Some countries, like Japan, have substantially lower unemployment rates but still appear to have output gaps and more work to do. In many of our economies additional aggregate demand would help speed the process of recovery, and in the United States, President Obama is pushing investments in areas like infrastructure and support for the long-term unemployed.

I am confident that we will eventually dig out of the hole left by the Great Recession. But even after we do, we will still face the major challenges that we faced in the decades leading up to the crisis. To understand those challenges I want to step back and talk about how we judge the economy. One of my jobs at the Council of Economic Advisers is briefing President Obama on all of the latest economic data. We send him memos on more than twenty different indicators each month and brief him in person on one or two of them. But if I could only have one indicator of how the economy is doing it would not be Advance Durable Goods Shipments or New Residential Sales. It would not even be GDP. It would be median household income.

Median household income is the best gauge of how typical families are doing in the economy. And, unfortunately, in the United States median family income has not made any net progress for the last fifteen years. Similar statistics for other OECD countries show that stronger income

growth for middle-class families in from the 1950s through the late 1970s has also given way to much slower growth or stagnation since then.

Why has this happened? The answer varies from country to country. In the United States, we have seen a substantial increase in productivity growth starting with the “New Economy” in the mid-1990s and continuing through today, but this growth has not translated into commensurate income gains for ordinary families, and inequality has increased substantially, due to a combination of technological change, education trends, institutional changes like declining unionization and a lower minimum wage, and globalization. Many other OECD countries, like in Europe and Japan, have seen inequality increase but by less and from lower levels. Instead, in these economies the biggest challenge for income gains has been that productivity growth rates have declined steadily throughout the postwar period, leading to slower overall growth.

Although the causes vary from country to country, the central economic goal is the same: how to both to strengthen growth *and* ensure that all citizens have full opportunity to share in that growth. By accomplishing this we will also help make sure that growth is more sustainable.

I want to talk about some lessons from around the OECD on how to promote more inclusive growth. Not all of the lessons I will talk about are economically desirable or politically feasible for all countries, but they give a sense of some of the approaches that one could consider.

I will talk about policies in four general areas:

The first set is policies that directly expand economic both growth and opportunity. One leading example in this area is preschool, which has among the highest returns of any area of economic investment. Mexico, France, Spain, and Belgium, to name a few countries, have close to 100 percent pre-school enrollment for three-to-five year olds. President Obama would like all Americans to have high-quality preschool and several States and cities are already moving forward on this goal. A range of other policies including expanded access to college and improved demand-driven training all have the potential to improve both growth and ensure that the benefits of growth are shared.

The second set of policies are ones that directly increase growth. Economists understand that there are three ingredients of growth: labor, capital, and what we can broadly call technology.

Countries have or are pursuing different approaches to expand labor. In France, for example, you see policies aiming at encouraging more births. In Japan, Abenomics is focused on increasing women’s labor force participation. In the United States, commonsense immigration reform is a top priority.

At the same time we need to improve investment, not just the quantity of investment but also its quality—which many countries have helped to achieve with business tax reform. Moreover, it is not just private investment but also public investment in areas like infrastructure. In this area, I do not have any OECD models to single out because we are almost all investing too little in our infrastructure. For nearly every OECD country, this type of investment is less than 2 percent of GDP. Many countries, however, have successfully demonstrated how to leverage private capital

for investments in infrastructure, including the European Investment Bank (EIB), the United Kingdom, and Canada, while Australia has placed a great deal of emphasis in recent years on improving its already very advanced public-private partnership model.

Technological advancement depends on a range of policies like public investments in research, tax subsidies for business research, and a legal and regulatory environment that encourages and rewards innovation. In addition, another way to expand total factor productivity is trade that allows greater specialization and focus on comparative advantage, which highlights the importance of agreements like the Trans Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (T-TIP).

The third set of policies is aimed at ensuring that everyone shares in the benefits of growth. Currently, countries including Switzerland and the United States are focused on raising their minimum wages while Germany is in the process of establishing one. In our case, President Obama's proposal to raise the minimum wage from \$7.25 per hour to \$10.10 per hour would benefit 28 million workers and move our minimum wage more closely in line with both its past inflation-adjusted value and with the current value in other OECD countries.

One place where the United States is a model and many other countries could potentially learn from us is the Earned Income Tax Credit, which provides a match of up to \$0.45 for each \$1 earned for families with children. This policy has been remarkably successful in reducing poverty, rewarding work, and encouraging increased labor force participation.

Policies that improve the income distribution can also affect growth. Historically economists worried that these sorts of policies would reduce growth. But more recently there is a growing recognition that high inequality, if left unaddressed, can be harmful for growth because it may encourage excessive financial leverage, limit human capital accumulation, reduce the trust and social cohesion essential for a market economy, and have harmful side-effects on the political system. And recent research from the International Monetary Fund (IMF) finds that in a sample with a wide range of countries, a more equal distribution of income is correlated with higher and more sustainable economic growth.

Finally, the fourth set of policies is concerned not just with incomes and wages, but about wealth. The increase in inequality we are seeing is increasingly driven by disparities in wealth and the returns to that wealth. This is especially true, at least in the United States, at the very top of the income distribution—like the top 0.1 percent or even 0.01 percent of households. One way to address wealth is with taxes at the individual level, and the United States has raised tax rates for high-income households on capital gains and dividends, and has also increased the tax rate on very large estates.

It is also important to focus on the corporate level, particularly preventing a race-to-the-bottom in corporate taxation that distorts business decisions, increases fiscal challenges, and undermines our ability to tax capital income. The Base Erosion and Profits Shifting (BEPS) process at the OECD which the G20 has endorsed is particularly important in this regard.

But it is just as important for our concern about wealth to focus on what we can do to help middle-class and moderate-income families accumulate wealth. In recent years a number of countries, including Italy, New Zealand, the United Kingdom and the United States, have started to take advantage of the fact taught to us by behavioral economics: that automatic enrollment and other sensible default options can make a large contribution to increasing retirement security and wealth creation.

To conclude, I am optimistic. OECD countries have a lot of potential for productivity growth. We have a lot of low hanging fruit in terms of policies that can both reduce inequality and increase economic growth. And these policies would promote the type of inclusive growth that would manifest itself in higher median incomes, lower poverty rates, and broader, more inclusive growth. I can tell you that the Administration in the United States is very focused on all of these areas and I am hoping that we can work together to draw lessons from each other's experiences and to cooperate on economic policies that would help advance these goals.