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"SCHUMPETER MEETS KEYNES AGAIN"

An OECD – IMF – BIS Conference discusses Financial Factors contributing to the productivity slowdown

Paris, 12 January 2018

On the 10th and 11th of January, the OECD joined up with the IMF and the BIS to organise a conference discussing the role of financial policies in explaining the trend of productivity slowing down across the global economy. Several technical research papers, covering different datasets, countries and approaches were presented. TUAC participated in this conference. Below are some impressions.

The conference theme ties up with a strand of work that the OECD Economics Department has been developing over the last years; this concerns the phenomenon of 'zombie firms'. These are older (at least 10 years of age) firms whose profits are so low that they are not able to pay the amount of interest on the debts they have incurred. Especially (but not exclusively) Southern European countries have seen their share of 'zombie firms' go up substantially. The OECD work claims that these "zombies" capture an important amount of capital and labour, thereby depressing the economy's productivity as firms that are healthy and more productive are deprived from resources they need in order to expand or even being created in the first place.

While the OECD mainly argues in favour of enhanced insolvency regimes in order to speed up restructuring or bankruptcy of 'zombie' firms, others take the argument further by pointing out that loose monetary policy, especially when interest rates are exceptionally low for a long period of time, allow low-productive firms to continue existing. The so-called 'cleansing' effect of a crisis is thus prevented and resources remain bottled up in low productive firms. One intervention went as far as claiming that the slowdown in productivity growth already started to happen back in the 1950's (for the US) and 1960's (for Europe) and that this neatly correlates with the trend decline in real interest rates. In all of this, the ghost of Schumpeter and the presumption that markets will transform destruction into creation is looming.

At the same time, a string of other (and equally 'robust') papers arrives at rather different conclusions. For Italian manufacturing firms, one paper found that reallocation, probably in the form of small family owned firms going out of business, does take place at an accelerated rate after 2008 but is hidden by an overall lack of demand that depresses productivity of all firms on average. There is a similar result for the UK reporting that the 'credit squeeze' tends to hit all firms alike, hence not producing some sort of 'allocation' effect that keeps the 'zombies' alive. Results from OECD research itself were used to point out that the 'zombie' effect was not very important as it is limited to just 0.6 percentage point, which is exactly of the same magnitude as the annual slowdown in productivity that has taken place since the onset of the crisis (from 1 to 0.3) and repeats itself each single year.

Another set of papers shifted the focus from productivity enhancing reallocation <u>between</u> firms to productivity increases <u>within</u> firms. These papers point out that tight credit conditions do matter as firms cut research and development and investment in response, especially those that go into the downturn with already high debt loads. One third of the slowdown in (total factor) productivity since the start of the crisis could be explained by this.

Going beyond the technicalities of econometric research, more interesting to observe was the reaction of those who are close to real life policy making and who started to echo rather typical 'Keynesian' arguments. Even if loose monetary policy harms productive reallocation, what is the counterfactual? No support for aggregate demand while the economy needs it most? Productivity in the UK would perhaps have been 1 or 2% higher if the Bank of England had put interest rates at 4 % and not at close to zero but the price would have been an additional loss of 1.5 million jobs or 5% of total employment in the UK. If 'zombie' firms are kept alive because banks fear the consequence for their license to operate in terms of capital requirements, then the solution is not to raise interest rates but to recapitalize the banks. With inflation still not back to target, there is still a lack of aggregate demand and monetary policy needs to keep up its support of the economy. A mix of weak balance sheets, credit squeeze and weak demand needs to be addressed by "very aggressive macro-economic policy'. And there is the question how the process of reallocating of resources actually works: It is one thing to 'free' up labour or capital but quite another thing to put it to work in more productive way.

Finally, the question of labour market functioning and wages in particular was not in the conference's remit but one participant accurately observed that the correlation between the trend decline in interest rates and productivity that is so central in the Schumpeterian mind set can be easily explained by a demand shock depressing wages. Indeed, a negative shock depresses inflation and interest rates but also wages. The latter then slows down the process by firms substitute labour for capital, thus depressing productivity. In other words, if you want to get productivity up, use demand policy to make sure the economy is operating at its fullest capacity!

Papers from the conference are available here: (http://www.oecd.org/global-forum-productivity/events/oecd-imf-bis-conference.htm)