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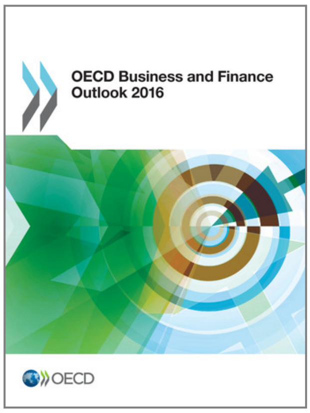
OECD Business and Finance Outlook 2016
Summary in English



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The theme of this year's OECD Business and Finance Outlook is fragmentation: the inconsistent structures, policies, rules, laws and industry practices that appear to be blocking business efficiency and productivity growth. It manifests itself at all levels of the global economy, from the global macro-economy to sectoral and micro-economic issues to legal ones.

Fragmentation in the global economy: financial markets and productivity

The global economy is caught between two major headwinds: the reversal of the investment-heavy commodity supercycle; and "L-shaped" recovery in advanced economies caused by the aftermath of the financial crisis and the interaction of re-regulation with low and negative interest rates. Normalisation of interest rates and a sustainable recovery of asset prices is shown to depend on which global scenario emerges: an "inflation first" set of policies favoured by central banks, and avoidance of a "creative destruction" phase to deal with over-investment and excess capacity in certain sectors and countries; or "productivity first" policies that bring about structural adjustment more quickly.

The best scenario would be one in which the low aggregate productivity growth of the post-crisis period improves. Company and sector value-added data of more than 11 000 of the world's largest listed non-financial and non-real-estate companies, taken from 20 different industry sectors, are used to analyse productivity performance at the firm level and to suggest priorities to improve it. The contribution to productivity growth of these companies is very narrowly based within each sector, indicating slow diffusion of gains across the economy. Best performance is encouraged by certain company financial decisions with respect to capital expenditure, sales, dividend and buy-back policies, research and development expensing, debt-versus-equity, and merger and acquisition activity.

Fragmentation at sectoral and micro-economic levels

Research and development (R&D) is one of the most important contributors to productivity growth and its diffusion. Accordingly, public policy has an important role in promoting it. Fiscal incentives, including tax policies, should be directed at specific barriers, impediments or synergies to facilitate the desired level of investment in R&D and innovations. Any tax incentives need to be considered in the context of the country's general tax policies, its broader innovation policy mix and its other R&D policies. More R&D activity in one country does not necessarily result in an overall increase in global innovation if it is simply shifted from another country.

Structural changes in the stock exchange industry have included fragmentation of the stock market resulting from an increase in stock exchange-like trading venues, such as alternative trading systems and multilateral trading facilities, and a split between dark (non-displayed) and lit (displayed) trading. Based on firm-level data, statistics are provided for the relative distribution of stock trading across different trading venues as well as for different trading characteristics, such as order size, company focus and the total volumes of dark and lit trading.

One important sector in which market fragmentation needs to be addressed is clean energy. Scaling-up investment in renewable electricity is critical for reducing greenhouse gas emissions from the power sector, and is therefore important for implementing the 2015 Paris Agreement on climate change. Despite increasing cost-competitiveness, overall investment in renewables projects remains constrained by policy and market obstacles. These hinder development of a sufficient pipeline of bankable projects and affect the risk-return profile of renewable electricity projects.

Finally, differences in life expectancy around retirement age across different socioeconomic groups raise issues for the insurance industry and pension funds as well as for public policy. Evidence from selected OECD countries based on measures of education, income and occupation shows that those in higher socioeconomic groups live longer than those in lower socioeconomic groups and these differences may be increasing over time. This makes it more challenging for pension funds and insurance companies to manage longevity risk. However, it also presents an opportunity to better tailor retirement solutions to the needs of different segments of society. Policy makers need to ensure that rules governing access to pensions and retirement savings do not put those in lower socioeconomic groups at a disadvantage.

Fragmentation of legal frameworks across countries

Variations in laws and legal regimes across countries unnecessarily fragment the economic environment by treating similar activities differently. One area where this is an issue is foreign bribery. In many jurisdictions sanctions are weak and foreign bribery may be an attractive investment. In others, foreign bribery is subject to strong penalties, although some of these are not backed up by effective enforcement. This patchwork of incentives and disincentives is explored using simulations of “net present value” for “investments in foreign bribery” under assumptions of both certainty and uncertainty. The simulations show that fines for bribery are set too low in many jurisdictions.

A second area where legal frameworks fragment the environment is investment treaties. These are concluded between two or more governments and typically offer covered foreign investors protection for their investments from host government conduct in violation of the treaty, such as expropriation without compensation, discrimination or treatment that is not “fair and equitable”. The unique combination of rules applied under many investment treaties, which include rules about the types of loss recoverable by shareholders covered by treaties and about the availability of damages for covered investors in claims against governments, creates different classes of shareholders with different sets of rights. This may be undesirable since it can allow covered shareholders to strip assets from the company to the detriment of company creditors and other shareholders.

Key findings and conclusions

Monetary ease has reached its limits in terms of stimulating most of the global economy. The key to better performance is structural reform across a broad range of policy domains in order to reduce fragmentation that hinders business performance and productivity. This will encourage needed investment in growing industries, such as renewable electricity, as the commodity supercycle reverses, while stimulating innovation and diffusion of its benefits to regenerate productivity growth after too many years of stagnation.

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