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Designing policies that support growth

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Implementing policies that work together to enable growth is our best opportunity to sustain rising global prosperity, says Catherine Mann, chief economist of the Organisation for Economic Co-operation and Development.

To achieve rising and shared prosperity requires not a silver bullet but an arsenal of policies deployed in systematic fashion. Most important, it requires a new level of understanding of how those policies interact and how they play out in the actual workings of an economy: among workers, in factories and offices, and between nations. This is a challenge, but policy makers can compare strategies and learn best practices to increase the likelihood for success. Moreover, in a globalized world, policy makers will need to consider each other's approaches even as they focus on their own goals.

And what is the goal? Productivity growth is necessary but not sufficient to support broad-based well-being, which also depends on quality of life, health, and environment. Productivity growth both affects and is affected by the distribution and volatility of employment and income—at the individual and household level—and these feed into well-being, both within and across generations.

Ongoing research is uncovering the complexity of the productivity process. As evidenced in the McKinsey case studies, and confirmed by analysis using firm-level data, current assessments of the future path of productivity underestimate the potential for improving the pace. Analysis with large firm-level data sets reveals the relative importance of different avenues of improving productivity.

The diffusion of best practices across firms within a sector, and the uptake of productivity-enhancing lessons learned across sectors can increase productivity within an economy and allow it to catch up to the frontier. Even in countries that are home to frontier firms, there is incomplete diffusion of known technologies within and, even more so, between sectors. Policies that support business and worker dynamism and the reallocation of resources promote this within- and between-sector diffusion and catch-up. But diffusion and catch-up are not enough to ensure rising prosperity: innovation that pushes out the technological frontier is also needed, and this depends on the extent and efficiency of resource reallocation, and the magic and confidence of ideas.

What holds back firm and worker dynamism? In the current environment, sluggish demand makes reallocation particularly costly. And local factors are certainly important in some (although not all) economies, such as access to credit and quality of business regulation. However, in general and across nearly all economies, one crucial factor limiting a firm's ability to restructure and reallocate is the poor match between workers and jobs. The matching process includes characteristics of the labor market and labor policies, but fundamentally this is about skills and location and the psychology of change. The reallocation process itself affects matching. Productivity growth tends to expose workers and households to increased job and income volatility, which adds to the growing inequality and low social mobility across generations. As the pace of technological change increases, and as people age, the need to change jobs and the nature of the work itself may increasingly bear on well-being.

Thus a pursuit of productivity alone will not maximize potential economic gains nor ensure shared prosperity. Even as we redouble our policy efforts to promote economic activity, we must deepen our understanding of how policies can improve the relationship among workers, working, and change and how regional and international policy affects individual economies. Research examining the behavior of individuals is starting to shed light on which policies can best help individuals navigate change. This is important also because faster and more efficient resource reallocation helps economies to recover more quickly from adverse shocks, thereby contributing to economic resilience, reduced inequality, enhanced productivity growth, and higher living standards.

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