Guest post: the free ride to convergence is over; EMs must boost productivity

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By Mario Pezzini of the OECD

The year 2010 was a turning point. What we didn't know at the time – but what new data just released have shown us – was that 2010 was the year when the share of non-OECD countries in the global economy surpassed that of OECD countries, at purchasing power parity. The rate of this shift has been remarkable: just 10 years earlier these countries accounted for 40 per cent of the global economy. The shift is being led by China and India, which together account for almost a quarter of the global economy.

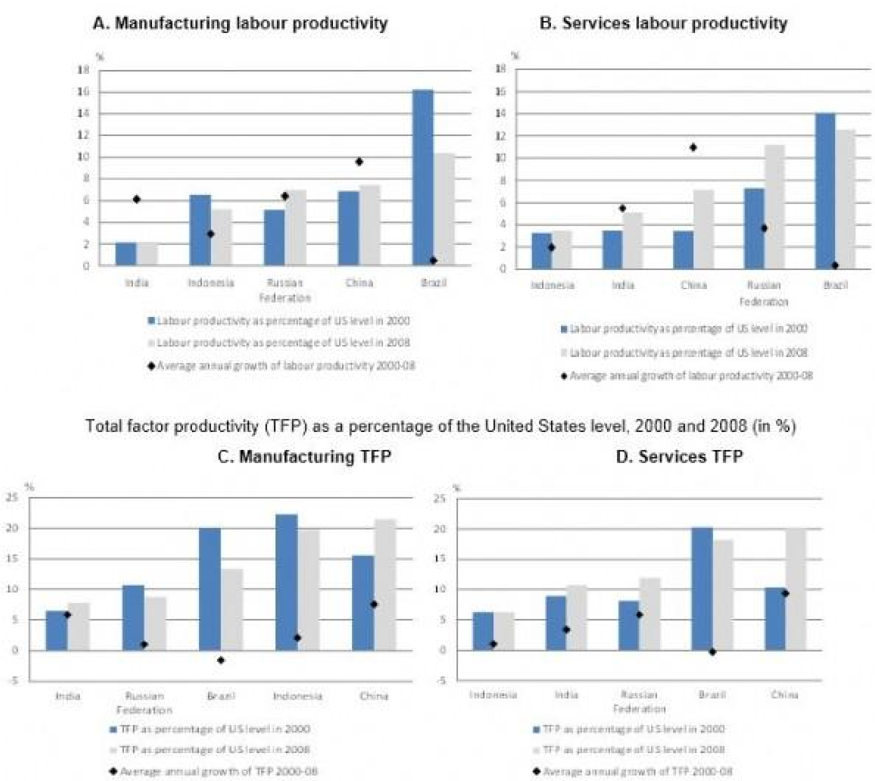
However, there has recently been a slowdown in the rate of growth of emerging economies, including China. At their average growth rates during 2000-2012, several lower middle-income countries such as India, Indonesia and Vietnam, but also countries in the upper middle-income bracket such as Brazil, Colombia, Hungary, Mexico and South Africa, will fail to converge with the average OECD income level by 2050. Their challenge is deepened by the slowdown in China, whose rapid growth in the past has benefited its overseas suppliers, especially natural-resource exporters. The free-ride towards convergence for many developing countries, based on China's growth, is over.

These trends add to concerns about emerging countries being unable to make the transition to high income levels and better living standards – what some refer to as the 'middle-income trap'. What we know is that sustained growth slowdowns can be linked with significant slowdowns in productivity growth. Boosting productivity must therefore be at the heart of boosting economic growth in middle-income countries, and is what the OECD Development Centre has been examining in this year's Perspectives on Global Development report.

Productivity levels in middle-income countries are still very low compared with advanced economies. For example, labour productivity was around 10 per cent of that of the US in 2008 in Brazil and the Russian Federation and even below that level in China, India and Indonesia. The gap is even widening in some countries due to a slowdown in productivity growth.

Productivity gaps in the BRIICS are large

Labour productivity (value added per employee in constant 2002 US dollars) as a percentage of the US level, 2000 and 2008 (%)



Source: Authors' estimations using Timmer, M.P. (ed) (2012), "The World Input-Output Database (WIOD): Contents, Sources and Methods", WIOD Working Paper Number 10

There are many ways to improve productivity. In early stages of development, it can be done by shifting labour from low to higher productivity activities – often from subsistence-level agriculture to manufacturing in towns and cities – and by the more intensive use of both capital and labour. Ensuring jobs for young people coming into the labour market is particularly relevant in developing countries with rapid growth in their labour force, such as Ethiopia, Cambodia or Pakistan. A failure to reap this "demographic dividend" in those countries would mean a major drag on their economies and, even worse, social tensions and instability.

The challenge for middle-income countries is that many of them have already largely reaped the gains to productivity from these shifts. Now countries need to find new ways to boost productivity. Using more sophisticated technology, as well as developing more effective ways to produce and deliver goods and services, becomes more important. Countries need to diversify their economies into higher value-added activities. To do this, they must increase the levels of educational attainment and skills of their labour force. The capability to innovate – to produce goods and services that are new to the economy – becomes vital. They can do this by replicating ways of producing and distributing goods and services that have already worked successfully in other countries. But countries can also develop their own ways which can better suit their specific conditions or give them a competitive edge internationally. There are also opportunities to boost growth and productivity by promoting knowledge-intensive services, advancing better regulation and competition policies, improving capital and labour markets, and facilitating a more effective integration into global value chains.

Ultimately, development goes beyond mere economic growth: it needs to be both inclusive and sustainable. The most effective combination of policies to reach this target will depend on the needs of each country as well as the ability of its government to develop and implement strategies. Governments need to obtain support for necessary reforms through consultation processes where key stakeholders – including businesses, local communities and civil society – can voice their opinions and help formulate and implement strategies. In addition to nation-wide policies, regional policies to support overall national objectives of stronger, fairer and greener economic growth are needed. The provision of basic services (including water, electricity, education and health) in all regions within a country is crucial. And more targeted regional policies can enhance each region's competitive edge and productivity. This will eventually aid the convergence in per capita income. Most importantly, the implementation of efficient policies to boost productivity and foster social cohesion relies on sound tax reforms.

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