BIAC THE VOICE OF BUSINESS AT THE OECD

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New Approaches to Economic Challenges – Synthesis Report[1]

Preliminary BIAC Comments, March 2015

BIAC appreciates the opportunity to contribute our comments on the draft NAEC Synthesis Report. Please note that due to the short deadline for comments, the following BIAC comments are preliminary in nature and further views may be provided in due course.

General Comments

BIAC has 3 overarching comments on the NAEC Synthesis Report:

1. **Further improve and nuance language about the virtues and trade-offs associated with policies for economic growth.** It needs to be made explicitly clear to the reader throughout the report that NAEC is neither side-lining economic growth, nor making social priorities the first objective of policymaking above all others, nor is it ignoring the wealth of policy expertise developed in the OECD's long history. Rather, we understand and appreciate that NAEC is about deepening knowledge and refining the toolkit in order that policymakers can take a more comprehensive approach to policymaking that considers economic, social and environmental aspects. Our detailed comments in the following pages provide line-specific suggestions in this regard.

2. **Recognize upfront that world economic growth is currently underperforming, and this calls for a comprehensive package of policies for growth.** This will be key for the *relevance* and *balance* of the NAEC Synthesis Report so that it not only tackles yesterday's financial crisis or tomorrow's long-term challenges, but also addresses the economic realities facing the world today. We appreciate that paragraphs 9, 10 and 11 do make this point well, but we encourage the authors to also reflect this message at the beginning of the Executive Summary and at other instances throughout the report. In this context, more needs to be said upfront about policy packages that will help to exploit new opportunities and reinvigorate investment, trade, innovation and entrepreneurship. More emphasis on open and efficient markets is needed, recognizing that they are the cornerstone of productive economies and societies.

3. **Include necessary qualifiers and nuance in parts of the NAEC Synthesis Report.** There are some parts of the report which make bold claims based on recent OECD analyses, but without the necessary qualifiers or nuance that can be found inside the original OECD project analyses. This may lead to an incomplete understanding. One key example is Paragraph 55 which argues that there is no trade-off between financial reform, long-term growth and income equality. We find this claim highly questionable, and we note that other parts of the NAEC report infer that such trade-offs may indeed

[1] SG/NAEC(2015)1, as of 24 February 2015.

exist. In our previously submitted set of comments, BIAC included several pages of detailed comments why much greater use of qualifiers and nuance is necessary in this paragraph. Moreover, we were informed at the last NAEC Group meeting in 2014 that a number of country delegates in the OECD body overseeing this piece of OECD research did not agree with the conclusions referenced in Paragraph 55. We urge the authors to carefully revise this part of the report. BIAC's specific comments in the following pages provide suggested edits for Paragraph 55, as well as other instances throughout the text where nuance is needed.

Specific comments

Executive Summary

- *Paragraph 1:* Immediately after the first sentence, we encourage the authors to copy relevant pieces of text from Paragraphs 10 and 11 of the Introduction section. This would increase the timeliness, relevance, and balance of the NAEC report, as per BIAC's 2nd general comment mentioned above. The revised text could for example be as follows (additions shown in yellow highlight):

  > *1. The starkness and magnitude of the recent crisis and its lingering legacy calls for a serious reflection, to revisit and supplement existing policy approaches and build a new policy agenda for stronger, more robust, inclusive and sustainable growth. The cylinders of the engine of growth (investment, trade, credit and emerging economies) are at half speed and there is a need to better understand why and how to overcome these current challenges. Lack of confidence and trust, combined with other uncertainties, are acting as a brake on global growth. The ensuing prolonged and subdued recovery in some countries is associated with labour hysteresis and discouraged investment.*
  >
  > *2. It is time to reshape our analytical frameworks, reconsider some of our fundamental assumptions and refine the policy tools we use. This is the objective of the New Approaches to Economic Challenges (NAEC) initiative. It is a* ***comprehensive organisation-wide reflection process*** *which is triggering and accelerating a* ***revision of our analytical frameworks*** *as well as a* ***renewal and strengthening of our policy instruments and tools.*** *The goal should be to inform and support a wide-ranging policy package for countries that includes structural reforms to boost investment, employment and potential growth; more monetary and fiscal stimulus where appropriate; and measures that address inequality and tackle the impact of the crisis on the most vulnerable.*

- *Paragraph 2, first sentence:* After the words "market efficiency", we recommend adding the words **"recognizing that GDP per capita is a key driver of average household disposable income".** Our suggested insertion is taken word-for-word from the OECD Economics Department Working Paper by Causa, de Serres, and Ruiz, 2014 (referenced elsewhere in the NAEC Synthesis Report). We believe the incorporation of this wording is important for the overall balance of the report.

- *Paragraph 2, second sentence:* Remove the word "fairness". This term is very vague and can be interpreted and applied in many different ways by countries, with significant consequences for economies and societies. The OECD has been rightly championing *equal access to opportunities,* and we feel this should continue to be the focus.

- *Paragraph 3, first sentence:* Remove the words "a change in", and replace with **"a more comprehensive set of".** NAEC should not be misinterpreted as calling into question or reinventing everything that the OECD has been working to achieve in its over 50 years' history. Instead of referring to a 'change' in objectives and perspectives, the text should make clear that NAEC is about taking a more comprehensive approach (as already mentioned in the current Paragraph 1 of the Executive Summary).

- *Paragraph 3, second sentence:* Remove the word "first". Replace the word "focusing" with "greater focus on". NAEC should avoid putting more or exclusive priority on wellbeing or social outcomes to the neglect of other objectives, as ultimately NAEC should provide an inclusive set of well-considered policy options – with economic, social and environmental considerations – to help guide policymakers. Also remove the words "and its distribution", which is often associated simply with increasing taxes, and replace with the words "throughout societies". Also replace "progress" with "opportunities". The revised sentence should therefore be (additions shown in yellow highlight):

  It ~~first~~ calls for ~~focusing~~ a greater focus on well-being ~~and its distribution~~ throughout societies to ensure that growth delivers ~~progress~~ opportunities for all.

- *Paragraph 9, second sentence:* While we support many of the statements made in Paragraph 9, part of the second sentence creates the impression that NAEC calls for new capital and liquidity requirements higher than those currently being implemented under the internationally-agreed Basel III program, and for new structural reforms which may differ from those already implemented in the US, UK, and parts of Europe. The current language gives the impression that the OECD is calling for a regulatory overhaul which could put the Organization at odds with the current G20-led international financial regulatory program. To clarify that NAEC supported the development of the *current* regulatory program, and does not call for new additional measures beyond the G20-led program in the areas of capital, liquidity and structural reform of banks, we recommend the following edit (addition shown in yellow highlight):

  To this end, NAEC ~~calls for strengthening~~ has supported the strengthening of the resilience of banks through higher capital and liquidity requirements as well as structural reforms…

- *Paragraph 11, third sentence:* We agree that the trade-offs and synergies associated with policies need to be understood. To improve the balance and comprehensiveness of the Executive Summary, we recommend that the following sentence – extracted from Causa, de Serres, Ruiz (2014) – be added *after the third sentence* of Paragraph 11 (additions shown in yellow highlight):

  > *…and distributional effects of different policies. Examples where synergies can be achieved include, for instance, reforms that: reduce regulatory barriers to domestic competition, trade and FDI; increase job-search support and activation programmes; and tighten unemployment benefits for all categories of jobseekers – all of which are found to deliver stronger income gains for households at the low end of the income distribution compared with the average household, thus helping to narrow inequality in disposable incomes. ~~This requires a~~ A comprehensive approach is therefore necessary to take ~~that takes~~ into account the different dimensions of inequality. To do so…*

- *Paragraph 11, final sentence:* This sentence calls for pursuing job quality together with job quantity, but refers only to labor market security, the working environment, and the level of revenues, with prime focus on the "well-being of workers". This is incomplete and we believe this sentence needs more balance in order to also reflect the needs of employers. We recommend the following edits (additions shown in yellow highlight):

  > *Labour market policies are another area in which policy makers need to broaden their objectives by **pursuing job quality together with job quantity,** targeting jointly labour taxation, labour market security, active labour market policies, the quality of the working environment, employment protection legislation, and the level of revenues, as those all affect the well-being of workers and the ability of firms to hire.*

- *Paragraph 12, third sentence:* We disagree with the phrase "It calls for increasing the stringency of environmental policies". Firstly, the conclusions of the OECD study from which it is derived does not call for increasing the stringency of environmental policies – instead, it simply concludes that "stringent environmental policies should not be expected to have detrimental effects on productivity", and that the design of stringent environmental policies "can and should be geared toward paying due attention to barriers to entry and competition, making the greening of the economy consistent with continuing productivity growth".[2] The research does *not* call for *increasing* the stringency of environmental policies (especially as such a general statement would ignore the high degree of cross-country variation in the types and stringency of environmental policies). Secondly, we find the word "stringency" has negative

[2] Albrizio, S., Botta, E., Kozluk, T., and Zipperer, V. (2014) "Do Environmental Policies Matter for Productivity Growth"? Insights from new cross-country measures of environmental policies", OECD Economics Department Working Papers No. 1176, Paragraph 49.

connotations and would be better framed in a positive way in order to encourage implementation where appropriate. We recommend the following edits (additions shown in yellow highlight):

> *It also calls for ~~increasing the stringency of~~ ambitious and consistent environmental policies ~~while~~ and ensuring they remain competition-friendly by using flexible, market-based instruments.*

- *Paragraph 13, fifth sentence:* Insert **"In addition,"** immediately prior to "business and finance". This edit is necessary to make clear that this sentence is not to be confused with the previous sentence (which concerned lobbying and political finance).

- *Paragraph 16, third sentence:* Delete the words "on its distribution", which suggests that NAEC is only focused on increasing taxes, and replace instead with **"on equal opportunities for all to prosper".**

- *Paragraph 16, final sentence:* The second part of this sentence isn't clear and needs revision.

Main text

- *Paragraph 7, second sentence:* Insert the words **"combined with insufficient supervision"** after the words "1980s and the 1990s". This would be consistent with Paragraph 9 of the Executive Summary which emphasizes the importance of better monitoring by financial supervisors.

- *Paragraphs 9, 10, and 11:* We fully support these paragraphs and recommend they be conserved in any future drafts of the NAEC Synthesis Report.

- *Paragraph 23, fifth sentence:* Delete the words "Without a change in the approach to economic growth", and replace with **"Without a more comprehensive approach to economic growth".** For explanation, please see our comment pertaining to Paragraph 3 of the Executive Summary and BIAC's first general comment above.

- *Paragraph 47, second sentence:* Insert **"combined with insufficient supervision"** after the words "financial institutions and markets". This would be consistent with Paragraph 9 of the Executive Summary, and our comment on Paragraph 7 of the main text (see above).

- *Paragraph 53, first sentence:* It may be an over-statement to suggest that the OECD has been at the forefront of the reform of banks. Firstly, the major post-crisis reform of banks (i.e. capital and liquidity requirements) has been led first-and-foremost by the relevant G20-mandated bodies, such as the Basel Committee and the FSB, to which the OECD has in cases provided supporting analysis. Secondly, OECD participation in the G20 and FSB (referred to in the final sentence of Paragraph 53) is in fact OECD *Secretariat* participation. We recommend therefore revising the first sentence as follows (additions shown in yellow highlight):

> *The OECD has been at the forefront of new thinking and analysis on the reform of banks.*

- *Paragraph 53, second sentence:* Remove the words "striking a better balance between" and replace with **"achieving better coordination between".** In the current post-crisis regulatory landscape, a major theme of the G20 in 2015 is on coordination to avoid potential unintended consequences of regulation.

- *Paragraph 55:* We have a number of strong concerns about this paragraph and it appears that the issues we raised in our previously submitted BIAC comments have not been sufficiently taken into account by the authors. Our views can be summarized as follows:

  Firstly, the main message of Paragraph 55 – i.e. that there is no trade-off between financial reform, long-term growth and income equality – is an ***oversimplification*** of the much more complex reality (e.g. it makes no reference to *which types* of financial reforms and in *which jurisdictions*), fails to acknowledge any of the ***limitations*** in the original Cournède and Denk paper (see Box 1 below), and is ***inconsistent*** with other parts of the NAEC Synthesis Report.[3]

  Secondly, there are none of the necessary ***qualifiers and nuance*** that should accompany the statements derived from the Cournède and Denk (2015) paper. Given the sensitivities around this particular issue, the current state of progress in the international regulatory reform agenda, and the possible economic and social consequences of providing potentially misleading information to policymakers, we underline the need for carefully balanced language in Paragraph 55.

Box 1: Shortcomings in the OECD analysis supporting Paragraph 55 of the NAEC Report

We refer to OECD Economics Department Paper "Finance and Inclusive Growth"

Latest edition received by BIAC: ECO/CPE/WP1(2014)16

The underlying OECD analysis focuses essentially on bank lending and largely excludes other financial activities, such as the insurance sector. Thus the OECD analysis states that its results "have to be interpreted with caution".[4] Paragraph 55 of the NAEC Synthesis Report should not therefore suggest that "the financial sector" (implying the sector as a whole) can diminish growth and contribute to income inequality.

The OECD analysis states that when the financial sector is well developed, further increases in its size can diminish growth, but recognizes that this is only a *marginal* effect.[5] Paragraph 55 of the NAEC Synthesis Report leads the reader to believe that the effect is more significant.

[3] Paragraph 53 refers to the need to strike a better balance between financial stability and growth, Paragraph 60 refers to the unintended consequences of financial reforms on economic growth, and Paragraph 164 refers to the reduced role of banking in financing investment and growth and the need for non-banks to play a bigger role (a difficult task). All of these paragraphs infer that there is in fact a trade-off between pro-stability financial reforms and growth.

[4] OECD Economics Department Paper "Finance and Inclusive Growth", ECO/CPE/WP1(2014)16, paragraph 6.

[5] Ibid, paragraphs 13, 17 and 20.

The OECD analysis recognizes that it uses a "novel" methodology to try to show a causal connection between the size of the financial sector and economic growth, but acknowledges that there is not an academic consensus on this connection. Paragraph 55 of the NAEC Synthesis Report should be much more prudent in the language it uses regarding causality.

The OECD analysis suggests that higher income people can and do borrow more, meaning they may gain more than others from their investment opportunities, and this may amplify income inequality. But the reason behind this is not explored or explained in the OECD analysis or NAEC Synthesis Report. In fact, a major factor influencing banks' willingness to lend is based on the creditworthiness of clients according to Basel II, Basel III, and rules on Risk Weighted Assets (RWAs). In order to lower their risk exposure, banks may be incentivized to lend to creditworthy households with higher incomes. This is one example where a trade-off between financial reform and income inequality may in fact exist, contradicting the main message of Paragraph 55 of the NAEC Synthesis Report.

The OECD analysis recognizes that "it did not investigate direct effect of individual financial policies on growth and inequality for lack of data that cover the policy stance of countries for long enough".[6] The statement made in Paragraph 55 of the NAEC Synthesis Report regarding the supposed lack of trade-off between financial reform, long-term growth and income equality is therefore misleading and should be revised. This would also be more in line with the current state of progress in the G20, which is currently focused on implementation and resolving any unintended consequences (e.g. trade-offs) associated with the international regulatory reform agenda. The OECD should not assert that such trade-offs do not exist.

BIAC's more detailed 2014 comments on the OECD analysis can be found in the annex enclosed in our previously-submitted "Preliminary BIAC Comments on the NAEC Outline" (December 2014).

Considering the above BIAC comments, in addition to the concerns raised by country delegates in the December 2014 NAEC Group meeting, we recommend either deleting Paragraph 55, or alternatively revising it along the following lines (additions shown in yellow highlight):

> *NAEC work also provides evidence on the impact of a growing financial sector on growth and inequality. Economies gain a lot from moving from a small financial sector to a more developed one. However, when the financial sector is already well developed, as has been the case in OECD economies, new research suggests that further increases in its size may in cases be correlated with ~~can~~ diminished economic growth (Cournède and Denk, 2015). Further analysis is needed to explain why this may be the case. In addition, research finds that financial expansion appears to be associated with ~~contributes to~~ income inequality in two ways (Denk and Cournède, 2015). First, higher income, more creditworthy people can and do borrow more, so that they can potentially gain more than others from the investment opportunities that they identify (Denk and Cazenave-Lacroutz, 2015). Second, the financial sector appears to pay~~s~~ higher wages than the*

[6] Ibid, paragraph 45.

> *rest of the economy for employees with similar profiles (Denk et al., 2015a).* ~~*This suggests that there is* ***no trade-off between financial reform, long-term growth and income equality,*** *even if reforms have the side effect of shrinking banking activities (Cournède et al., 2015).*~~ *Again, further research is needed to understand the factors behind these findings and any possible trade-offs and synergies that may exist between pro-stability financial reforms, long-term economic growth, and income equality.*

- *Paragraph 56, second and third sentences:* Rather than only inferring that the negative association between bank lending and growth is due to too much private-sector debt holding back GDP growth, the paragraph should first explicitly recognize that the direction of causality is not clear-cut and subject to debate.[7]

  In order to provide a truly comprehensive and inclusive understanding, the NAEC report should also present the other possible direction of causality – i.e. that low growth may encourage more bank-lending. It would indeed be plausible that, in periods of low growth, bank lending may increase because that is exactly what a well-functioning financial sector is designed to do – i.e. to provide credit to households and non-financial corporations precisely when it is most needed.

  The text should furthermore emphasize that high quality credit intermediation is linked with higher growth (see paragraph 19 of the OECD paper *"Finance and Inclusive Growth", latest edition received by BIAC: ECO/CPE/WP1(2014)16).*

  We therefore recommend the following edits to Paragraph 56 (additions in yellow highlight):

  > *…It shows that, beyond a certain level, bank-lending expansion might have a stronger negative association with growth than increases in capital-market credit (Cournède and Denk, 2015). Similarly, increases in credit to households could have a more negative association with growth than credit to businesses. One possible explanation is that bank lending expands during periods of low growth in order to provide credit to households and businesses precisely when it is most needed. However, expansion in stock-market funding* ~~*is*~~ *may be good for growth. High quality credit intermediation is also linked with higher growth. More work is needed to understand whether there are causal links in all of these correlations. An important policy conclusion from this work is that reforming the tax treatment of debt and equity* ~~*is*~~ *may be important to move towards a healthier* ~~*more healthy*~~ *financial structure in the future (see Section 3.2.1).*

- *Paragraph 111, first sentence:* The statement that "reforms that boost innovation widen the wage distribution among employed workers" together with the second sentence

[7] The underlying Cournède and Denk (2015) paper finds mixed views in the academic literature on the direction of causality (see paragraph 37 of the OECD paper "Finance and Inclusive Growth", latest edition received by BIAC: ECO/CPE/WP1(2014)16).

of the paragraph, not only seem to contradict the first part of the first sentence, but also provide only a partial representation of the findings raised in the de Serres and Yashiro (2014) paper that is referenced in the NAEC Synthesis Report. It is essential to represent the other main findings of the de Serres and Yashiro 2014 paper for the sake of proper balance in the NAEC report, such as: "a number of reforms unambiguously reduce wage dispersion and/or household income inequality", and "many [pro-growth structural reforms] have little or no impact on income inequality among households, even when they widen the wage dispersion, due to offsetting employment effects".[8] We therefore recommend revising Paragraph 111 as follows (additions shown in yellow highlights):

> *NAEC projects have examined whether structural policies that increase economic growth also improve median households' disposable income, finding for example that a number of reforms unambiguously reduce wage dispersion and/or household income inequality, but that some reforms that boost innovation widen the wage distribution among employed workers. Some other ~~Other~~ policies that promote labour force participation and job creation may also be associated with a widening of wage dispersion, but ~~. However,~~ higher wage dispersion among workers does not necessarily translate into wider income inequality, because the effects of growth-oriented reforms can improve the employment opportunities of those looking for a job ~~in some cases they may contribute to raising employment~~ – not least among lower-skilled workers – thereby offsetting at least some of the resultant increase in income inequality (Divided we Stand, 2011; Causa, de Serres, and Ruiz, 2014).*

- *Paragraphs 112 to 114:* BIAC agrees it is important to have a clear understanding of the structure and level of energy taxes. We generally underline that the focus should not be on increasing fiscal revenues and that economic and social side-effects of increasing fiscal burden need to be taken into account. Due consideration needs to be given to fiscal neutrality, the overall fiscal mix and fiscal burden, and consequences for growth, competitiveness and revenue neutrality. There will be social implications to pricing energy use and targeted measures to deal with this should be considered. With regards to subsidies, while BIAC agrees with the need to address the issue of environmentally harmful subsidies, we also encourage the OECD to analyse the energy subsidies broadly to assess their harmful environmental effectiveness and economic efficiencies. Any changes considered to existing legislation should bear in mind the reason for putting it in place in the first place and whether the changes address the core policy objectives.

- *Paragraph 150, last sentence:* This sentence should make clear that action is therefore needed to develop skills, and not to limit reliance on knowledge-based assets (KBA). After the words "high skills", we recommend adding: **", thus warranting improvements to education systems and skills development".**

[8] De Serres, A. and Yashiro, N. (2015) "The effects of pro-growth structural reforms on income inequality", in *Economic Policy Reforms 2015: Going for Growth,* OECD Publishing, p76.

- *Paragraph 164:* We appreciate this paragraph which recognizes that "regulation and capital requirements have reigned in the banking sector", meaning that "banking plays a reduced role in financing investment and growth". While the paragraph states "non-banks will need to play a bigger role", it should be borne in mind that this will not happen easily or quickly, particularly in Europe where bank lending is considerably more intense than in some other major markets, and thus growth and investment are likely to be negatively impacted for a considerable amount of time so long as banking activities are constrained. At the end of this paragraph, we recommend adding the following sentence:

  > *Further research is needed to fully understand the consequences of regulations on financing investment and growth in a bank-constrained world.*

- *Paragraph 167:* We are concerned that the statements as currently written in this paragraph may appear somewhat out-of-step with the latest developments in the G20-led internationally-agreed financial reform agenda. We also believe that while excesses should indeed be avoided, there is a need for a healthy dose of risk-taking to encourage investment. Our recommendations are as follows (additions shown in yellow highlight):

  > *Healthy banks make for better lending. Avoiding financial excesses and supporting lending to the real economy is key, but with an appropriate degree of risk-taking to generate growth and investment. ~~A healthy future for finance involves avoiding excesses that can hurt growth and income inequality.~~ While the current G20 financial reform agenda is well underway and has already achieved much to make the financial sector safer and more resilient to shocks, the focus now should be on the completion of the agenda and implementation of ~~further efforts are needed especially to implement~~ measures for addressing too-big-to-fail and competition issues.*

- *Paragraph 168:* We strongly recommend deleting this paragraph due to the following three reasons:

  Firstly, the second sentence claims that "much remains to be done in particular to reduce governments' implicit support for too-big-to-fail institutions". This statement appears outdated and out-of-step with the latest developments at the G20 and FSB. The FSB Chairman, Mark Carney, stated in an October 2014 speech that "*the FSB is on track to agree proposals that, once implemented, will be decisive in achieving [the end of 'too-big-to-fail']*".[9] In his words, the G20 Brisbane Summit was "*the watershed in ending Too Big to Fail*". Moreover, the sentence repeats much of what is already written in Paragraph 167.

[9] Remarks by Mr. Mark Carney, Governor of the Bank of England and Chairman of the Financial Stability Board, at the 29th Annual G30 International Banking Seminar, Washington DC, 12 October 2014. See here: http://www.bis.org/review/r141015c.htm

Secondly, the third sentence calls for "structural reforms of OECD banking sectors". Again this appears to be outdated, as several jurisdictions are already implementing their own approaches for reform (such as the US Volcker rule, the UK Vickers report, separate French and German legislations, and the European Commission's proposals). It is it really the agreed position of the OECD that jurisdictions such as these need to do more, and if so, in which way?

Thirdly, the final sentence of the paragraph suggests that structural reforms of banks "can benefit consumers and companies alike, in particular SMEs which still depend largely on bank lending". In our view, this statement is not supported by comprehensive evidence or impact assessments, and we believe that in fact the opposite may be true. SMEs in many jurisdictions, particularly in Europe, need large universal banks. They need loans, and, increasingly, sophisticated financing (innovation, international expansion, and mergers & acquisitions) and risk hedging solutions (derivatives, interest rates, commodities and equities) – especially to access global value chains. As a result of structural reforms of banks, it is probable that SMEs may no longer be able to access vital financial products or may have to pay a much higher price in order to do so, with likely negative consequences for their engagement in cross-border activities. National economic competitiveness could be impaired. To summarize, the supposed benefits of the proposed reforms are by no means assured, and indeed there is far too little attention given to the possible costs of such reforms.

We therefore recommend deleting Paragraph 168.

- *Paragraph 170:* BIAC agrees it is important to have a clear understanding of financing structures (i.e. debt vs equity funding) and their impact on efficient resource allocation, achieving greater macroeconomic stability and supporting sustainable long-term growth. In the OECD/G20 BEPS Project, several governments have expressed concern about inappropriate interest deductions that reduce taxable income, and BIAC agrees that such concerns should be addressed. However, as the use of debt and intercompany funding is crucial to the functioning of many businesses from large multinational groups through to small cap companies, BIAC cautions that careful consideration should be taken before imposing substantial restrictions on all taxpayers.

- *Paragraph 179:* This paragraph doesn't appear to give due consideration to the papers by de Serres and Yashiro (2015) and Causa, de Serres, and Ruiz (2014), cited in other places in the NAEC Synthesis Report, despite the fact that both of these papers address exactly the distributional effects of pro-growth policies (the focus of Paragraph 179). As mentioned above, for example, the de Serres and Yashiro 2014 paper finds that "a number of reforms unambiguously reduce wage dispersion and/or household income inequality", and "many [pro-growth structural reforms] have little or no impact on income inequality among households, even when they widen the wage dispersion, due to offsetting employment effects".[10] We therefore believe that greater nuance is

[10] De Serres, A. and Yashiro, N. (2015) "The effects of pro-growth structural reforms on income inequality", in *Economic Policy Reforms 2015: Going for Growth,* OECD Publishing, p76.

required in this paragraph, and we suggest the following edits (additions shown in yellow highlight):

> ***…due in part to some pro-growth policies neglecting distributional effects…***
>
> *Growth driven by skill-biased technical progress benefits mostly highly skilled individuals and those with investable assets. Structural policies can promote growth, but ~~they~~ some might be ill-equipped to deal with the trade-offs between growth and equity objectives. Structural policies that promote more flexible labour markets facilitate job creation and employment among low-skilled workers, but also tend to widen the dispersion of wages, with unclear net effects on the income levels of households in the lowest income bracket. Similarly, fiscal policies aimed at reducing the tax burden have often meant lower redistribute capacities of governments. There are trade-offs too in some policies that enhance competition in product markets, especially environmentally-friendly policies that remove subsidies on harmful fuels. On the other hand, many structural reforms have little or no impact on income inequality among households, even when they widen the wage dispersion, due to offsetting employment effects (de Serres and Yashiro, 2015), while others are found to deliver stronger income gains for households at the low end of the income distribution compared with the average household, thus helping to narrow inequality in disposable incomes (Causa, de Serres, and Ruiz, 2014).*

- *Paragraph 181, heading in bold:* Insert the word **"Excessive"** immediately prior to "income inequality". Income inequality may only be detrimental to growth if it surpasses a certain level. It would be misleading for NAEC to suggest that any extent of income inequality is detrimental for growth.

- *Paragraph 183, third sentence:* After this sentence, we recommend inserting a fourth sentence referring again to the findings in the paper by Causa, de Serres, and Ruiz (2014) of synergies between certain structural reforms and equality (addition shown in yellow highlight):

> *…to off-set rising income inequality. Other examples where synergies can be achieved include, for instance, reforms that: reduce regulatory barriers to domestic competition, trade and FDI; increase job-search support and activation programmes; and tighten unemployment benefits for all categories of jobseekers – all of which are found to deliver stronger income gains for households at the low end of the income distribution compared with the average household, thus helping to narrow inequality in disposable incomes (Cause, de Serres, and Ruiz, 2014). Moreover, easing employment…*

- *Paragraph 184, first sentence:* Immediately prior to the words "inequality has detrimental effects on growth", insert the word **"Excessive".** See our comment on Paragraph 181 for explanation.

- *Paragraph 193:* We recommend deleting this sentence and replacing it simply with **"Environmental policies should be designed in a way that they successfully address environmental objectives with minimum burden on economic activity".** This would make the sentence more forward-looking.

- *Paragraph 197:* We are concerned by the heading "Increase the stringency of environmental policies". Firstly, the conclusions of the OECD study from which it is derived does not call for increasing the stringency of environmental policies – instead, it simply concludes that "stringent environmental policies should not be expected to have detrimental effects on productivity", and that the design of stringent environmental policies "can and should be geared toward paying due attention to barriers to entry and competition, making the greening of the economy consistent with continuing productivity growth".[11] The research does not call for *increasing* the stringency of environmental policies (especially as such a general statement would ignore the high degree of cross-country variation in the types and stringency of environmental policies). Secondly, we find the word "stringency" has negative connotations and would be better framed in a positive way in order to encourage implementation where appropriate. We recommend the following edits (additions shown in yellow highlight):

  Increase the ambition ~~stringency~~ of environmental policies

  Bold ~~More ambitious~~ and efficient policies are needed to reconcile economic growth with the conservation and sustainable use of the environment and natural resources. New OECD data on the stringency of environmental policy instruments across OECD countries over the past two decades suggest that more ~~stringent~~ ambitious and consistent environmental policies may have on average no long-lasting negative or positive effects on multifactor productivity growth (Albrizio et al., 2014). The effects of…

- *Paragraph 200:* The term "international competitiveness" should be specifically mentioned in this paragraph.

Annex III

- *Row 1, 'Environment' column:* Delete the words "environment stringency", whose meaning is unclear, and replace with **"the ambition and consistency of environmental policies".**

[11] Albrizio, S., Botta, E., Kozluk, T., and Zipperer, V. (2014) "Do Environmental Policies Matter for Productivity Growth"? Insights from new cross-country measures of environmental policies", OECD Economics Department Working Papers No. 1176, Paragraph 49.

- *Row 1, 'Equity/Well-being column:* The key conclusions of the Causa, de Serres, and Ruiz (2014) paper should be reflected in this table. We recommend inserting a bullet in this box which says: **Reducing regulatory barriers to domestic competition, trade and FDI; increasing job-search support and activation programmes; and tightening unemployment benefits for all categories of jobseekers.**

- *Row 2, 'Growth' column:* Add a bullet which says **"Pro-stability financial reforms may have unintended consequences for economic growth and investment".** This reflects the concern highlighted in Paragraph 60 of the NAEC Synthesis Report.

- *Row 2, 'Equity/Well-being' column:* After the statement "Making the financial sector more stable can reduce inequalities (A3)", add the words ***"(though possible trade-offs, such as reduced availability of credit for low-income households, need to be considered).***

- *Row 3, 'Growth' column:* After the statement "Boosting growth can have a negative impact on the environment", add the words **"if economic policies neglect to consider their potential consequences for environmental degradation".**