Global issues

**Recent slowdown in productivity growth highlights medium-term challenges for developing countries**

Recent indicators have shown a gradual strengthening of global economic activity since late 2016. In tandem with an improvement in aggregate demand, international trade and manufacturing output have rebounded, while commodity prices have risen from their lows seen in early 2016. Amid a general improvement in business sentiment, several large economies, including the United States of America and Japan, are experiencing a moderate recovery in investment. Against a backdrop of elevated uncertainty and downside risks, however, it is still unclear whether this positive global growth momentum can be sustained going forward. Several lingering structural weaknesses are also constraining the medium-term growth outlook. Of particular concern is the prolonged and broad-based weakness in global productivity growth since the global financial crisis.

Figure 1 compares labour productivity growth trends in developed and developing regions between 1995 and 2016. Prior to the 2008-09 crisis, developing economies had been experiencing a rapid acceleration in labour productivity growth. In contrast, average productivity growth in developed countries had been on a longer term downward trend. In recent years, while productivity growth in developing economies has been steadfast than in developed countries, its pace has slowed considerably compared to the pre-crisis period. This persistent weakness in productivity growth has generated widespread concern given that it is a long-term determinant of income and living standards. For developing economies, prolonged weak productivity growth will not only adversely impact medium-term growth prospects, but may also severely undermine progress in achieving the Sustainable Development Goals. It is therefore important for policymakers to understand the factors driving slower labour productivity growth in developing economies.

Labour productivity is commonly measured as total output per person employed, or as total output per hour worked. Growth in labour productivity for an economy is driven by three key factors, namely, improvements to labour quality; capital deepening (available capital per worker); and, growth in total factor productivity (TFP). TFP is a measure of an economy’s efficiency in allocating its factors of production and is influenced by various factors, including...
technological progress and institutional changes\(^2\). For developed economies, the slowdown in labour productivity growth has been largely attributed to the decline in the contribution from capital formation\(^3\). This reflects the persistent weakness in investment growth in these economies since the financial crisis, as capital spending remains constrained by sluggish demand, high uncertainty and fragile bank balance sheets.

Across many developing regions, however, capital deepening has continued to contribute positively to labour productivity growth, implying that investment in new capital has held up relatively well in the post-crisis period (figure 2). Instead, the recent slowdown in labour productivity growth in developing countries has been mainly due to a deceleration in TFP growth. This suggests that developing countries are, on average, experiencing slower efficiency gains and technological absorption following the recession.

Several cyclical and structural factors appear to have contributed to the broad-based slowdown of TFP growth in developing economies. On the cyclical front, subdued demand conditions—amid high uncertainty in the post-crisis environment—may have affected the quality of investment, resulting in lower TFP growth. In addition, recent evidence has shown that TFP growth in the commodity-exporting economies tends to move in tandem with commodity prices, given that commodity-related income facilitates investment in technology and human capital. Hence, the end of the super-cycle of commodity prices in recent years has contributed to the slowdown in productivity growth in several regions, including in Africa, Latin America and Western Asia.

Beyond these cyclical factors, several structural shifts had also taken place, notably the waning effects of past advances that catalysed strong TFP growth in the last two decades. First, the surge of information and communication technology in the 1990s contributed to improved productivity in the global economy, including in developing economies. Second, earlier structural reforms and transformation processes spurred large productivity gains in several countries. For instance, China’s transition from an agrarian economy to an industrial powerhouse was accompanied by rapid technological progress and increased workforce efficiency. Third, major trade liberalization efforts, such as the formation of the European Union and China’s accession into the World Trade Organization, drove rapid growth in international trade in the 2000s. This development could have stimulated TFP growth in many developing economies, given that trade increases competition and drives the distribution of new technology\(^4\). In particular, the proliferation of global value chains, for example in East Asia, not only generated large economies of scale, but also allowed for exporting firms to acquire new production techniques.

It is also important to highlight that a country’s potential to achieve stronger productivity growth is also influenced by its economic structure. Countries with a high dependency on natural resources face larger constraints to productivity growth, compared to countries where high technology manufacturing activities are more prevalent. In general, developing regions like Latin America or Western Asia have had limited success in promoting a process of structural change towards more technologically advanced sectors, thus restraining productivity gains through technical progress and innovation.

In the medium term, policy efforts in developing countries need to be geared towards reversing the current trends in productivity growth to enhance economic resilience and sustain growth prospects. Further progress needs to be made on structural reforms that can boost TFP growth. This includes strengthening governance, improving the quality of education and promoting initiatives to enhance innovation as well as investment in research and development.

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**Figure 2**

Contribution to labour productivity growth, by region

<table>
<thead>
<tr>
<th>Percentage points</th>
<th>Capital deepening</th>
<th>TFP</th>
<th>Labour quality</th>
<th>Labour productivity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995-2000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>East and South Asia</td>
<td>1.5</td>
<td>2.3</td>
<td>0.7</td>
<td>0.2</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>1.0</td>
<td>1.2</td>
<td>0.3</td>
<td>0.2</td>
</tr>
<tr>
<td>Africa</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001-2007</td>
<td>0.5</td>
<td>0.7</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>2011-2015</td>
<td>0.5</td>
<td>0.7</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Western Asia</td>
<td>1.0</td>
<td>1.2</td>
<td>0.3</td>
<td>0.2</td>
</tr>
</tbody>
</table>

**Source:** UN/DESA estimates based on The Conference Board Total Economy Database™ (Adjusted version), November 2016, available from http://www.conference-board.org/data/economydatabase/

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\(^2\) Total factor productivity is usually estimated as a residual. It is therefore subject to considerable measurement errors, particularly in developing countries with data limitations.


**Developed economies**

**United States: Disappointing start to 2017**

Gross domestic product (GDP) growth in the United States was on the downside in the first quarter of 2017, with the advance estimate showing growth of just 0.7 per cent on an annualized basis. While consumer confidence indicators rose following the elections in November 2016 and remain high today, this has not yet translated into stronger household spending. Personal consumption expenditure showed negligible growth in the first quarter of the year, with a sharp decline in spending on durable goods. A downward adjustment to the level of private inventories also contributed to the economic slowdown, reducing GDP growth by 0.9 percentage points. There is a risk that the weaker-than-expected GDP growth may lead to a reversal of the upbeat economic sentiment and buoyant stock market performance in the United States, putting the Government’s target of achieving annual GDP growth of 3 to 4 per cent further from reach.

The Federal Open Market Committee (FOMC) of the United States Federal Reserve kept interest rates unchanged at its meeting in May. While financial markets continue to expect a 25 basis points rise in interest rates in the United States at the next monetary policy meeting in June, the FOMC may move more slowly if confidence indicators deteriorate or if signs of an acceleration in real economic activity fail to emerge.

**Japan: Unemployment rate at 22-year low**

The unemployment rate in Japan dropped to 2.8 per cent in February and remained stable in March, the lowest level recorded since 1994. At the same time, the Tankan factor utilization index stands at its highest level since 1990 and the Bank of Japan’s (BoJ) estimate of the output gap is positive, showing positive gaps in both labour and capital inputs. The BoJ is committed to maintaining its policy of “Quantitative and Qualitative Monetary Easing with Yield Curve Control”, aiming to achieve the price stability target of 2 per cent. Nonetheless, wage pressures remain moderate and inflation is unlikely to reach the central bank target this year or next. Nationwide consumer price inflation averaged -0.1 per cent in 2016, but has been positive in the first months of 2017, hovering close to zero. The uptick in inflation, which reached 0.2 per cent in March, primarily reflects higher energy prices and the depreciation of the yen in late 2016.

**Europe: Slower inflation and solid gains in nominal wages**

In March, inflation in the European Union slowed to 1.6 per cent from 2.0 per cent in the previous month, due mainly to a slower increase in energy prices. Romania, with 0.4 per cent, and Ireland and the Netherlands, both with 0.6 per cent, registered the lowest inflation rates in the region, while Latvia and Lithuania experienced the fastest price increases, at 3.3 per cent and 3.2 per cent, respectively. At the same time, nominal wages showed solid gains in several countries. In Germany, nominal wage growth in industry reached 3.0 per cent in February, which translated into some gains in real purchasing power due to the moderate level of inflation.

Similarly, in Poland, the average wage level increased by 5.2 per cent in March, although one-off payments underpinned part of this increase. In both cases, these trends will further drive private consumption, which has been playing an important role for the overall growth performance.

As inflation in the Czech Republic was unexpectedly on the upside in March, reaching 2.6 per cent, in early April the Czech National Bank concluded its policy of maintaining a ceiling on the value of the koruna, which was initiated in late 2013 as an additional monetary policy tool.

**Economies in transition**

In the first quarter, macroeconomic indicators in the Commonwealth of Independent States (CIS) area show a heterogeneous growth performance. In Central Asia, Kyrgyzstan recorded strong GDP growth of 7.8 per cent as gold production increased, while a recovery in remittances from the Russian Federation bolstered household income. In the Caucasus, the economic activity indicator strengthened considerably alongside an appreciation of the domestic currency, and in Ukraine.

Belarus, where inflation subsided considerably alongside an appreciation of the domestic currency. In the Czech Republic was unexpectedly on the upside in March, reaching 2.6 per cent, in early April the Central Bank of the Czech Republic raised its policy rate by 50 basis points to 9.25 per cent. Due to still high real interest rates, however, this move will impact carry trade and the exchange rate only moderately. Policy rates were also reduced in Azerbaijan and Uzbekistan, where inflation accelerated to 14.5 per cent in March, driven by higher food prices. Inflation also increased in Ukraine to 15.1 per cent, due to higher production costs.

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In the Russian Federation, inflation is contained at slightly over 4 per cent, in part held back by subdued domestic demand, but also the strong rouble bringing down import prices and inflationary expectations. In late April, the central bank further reduced its policy rate by 50 basis points to 9.25 per cent. Due to still high real interest rates, however, this move will impact carry trade and the exchange rate only moderately. Policy rates were also reduced in Belarus, where inflation subsided considerably alongside an appreciation of the domestic currency, and in Ukraine.

In South-Eastern Europe, the Albanian economy expanded by over 3.4 per cent in 2016. Robust export performance significantly contributed to growth in the fourth quarter. The country has absorbed about €1 billion of foreign investments in 2016.

**Developing economies**

**Africa: Plummets cocoa prices hit West African economies**

Plummets prices are hurting the finances of cocoa producing countries and incomes for hundreds of thousands of small-scale farmers. Cocoa prices have plunged by over 40 per cent since last year, hitting a 10-year low, as a result of bumper crops and stagnant demand around the world. Cocoa is the main produce of Côte d’Ivoire and accounts for about a fifth of the nation’s exports. It is also among the main exports of Cameroon, Ghana, Guinea, Nigeria, São Tomé e Príncipe and Sierra Leone.
In Cameroon, the price decline is affecting 600,000 households whose livelihoods are derived from cocoa. Ghana, the second largest world producer of cocoa, has lost almost $1 billion in export revenue. Côte d’Ivoire, the world’s top cocoa exporter, announced that it would reduce its 2017 budget by one tenth, although the move was also triggered by wage demands from civil servants and soldiers. The decision follows a recent one to cut prices paid to farmers by 36 per cent, as a disincentive to raise output. In the coming months, the World Bank will grant the country $100 million to $125 million in budget support. Coca-growing countries plan to fight the price rout by coordinating production strategies and promoting local consumption of chocolate.

There is, however, room for some optimism. Though a production surplus is likely to last through this year, the price weakness is not uncharacteristic of the market, which has seen considerable historical volatility. Most importantly, there is potential for growth in world cocoa consumption, given the possible demand growth in developing markets over the long term.

**East Asia: First quarter growth exceeds expectations**

Amid an improvement in domestic demand and a recovery in exports, a few major East Asian countries experienced faster-than-expected growth in the first quarter of 2017. In China, GDP growth picked up slightly to 6.9 per cent on a year-on-year basis. The industrial sector expanded at a stronger pace, driven in part by government stimulus measures and continued rapid credit growth. In the tertiary sector, services such as accommodation, real estate, retail and finance grew at a faster pace. However, these improvements were more than offset by a deceleration in transport and other services. From a demand perspective, private consumption remained the largest contributor to GDP growth, supported by a rise in disposable income and stronger job creation. Growth in fixed asset investment also accelerated, driven mainly by infrastructure and real estate investment.

Despite high political uncertainty, the economy of the Republic of Korea expanded at a faster pace of 2.7 per cent in the first quarter. Exports rebounded during the quarter, bolstered by an increase in shipments of semiconductors and machinery and equipment. Growth was also supported by stronger investment in facilities and sustained private consumption. Similarly, Taiwan Province of China also grew at a faster-than-expected pace of 2.6 per cent, driven mainly by higher exports of electronics. In addition, the recent announcement of a $29 billion (5.2 per cent of GDP) stimulus package, spread over 8 years, will provide a boost to domestic demand going forward.

**South Asia: Pakistan’s external sector deteriorates visibly, underscoring medium-term challenges**

Since early 2016, the external sector has visibly deteriorated in Pakistan, owing to largely stagnant exports and a significant rise in imports. In the nine months to March 2017, the trade deficit increased by 28 per cent year-on-year to a record high of $19.7 billion, with the monthly import bill surpassing $5.0 billion for the first time in March. In particular, export growth has been restrained by relatively subdued external demand, growing competition in the garment sector from other Asian economies, and structural constraints, including power shortages. Meanwhile, imports of goods have increased markedly due to the implementation of large infrastructure projects, including the Pakistan-China Economic Corridor. As a result, the current account deficit has widened considerably, while international reserves declined from almost $19 billion in October 2016 to $17.1 billion in February 2017. These developments have prompted the Government of Pakistan to seek additional foreign loans from multilateral institutions and Chinese State-owned banks. In the short-term, the Pakistan economy is expected to navigate these external headwinds, amid solid private consumption and investment demand. In the medium term, however, strengthening the competitiveness of exports in Pakistan is a key challenge in order to reduce its external fragilities and to achieve a stronger, more balanced and sustainable growth.

**Western Asia: Rising unemployment**

Unemployment rates are climbing in Western Asia, except for Israel where the unemployment rate remains at a historically low level. The Turkish unemployment rate reached 13 per cent in January 2017, the highest since February 2010. The unemployment rate among the Saudi nationals, excluding foreign labour, stood at 12.3 per cent in the fourth quarter of 2016, the highest since the first half of 2012. The unemployment rate of Jordan remained at 15.8 per cent in the fourth quarter of 2016, the highest since 2003. The large number of settled Syrian refugees and evacuees has pushed up the unemployment rate in Jordan and Turkey, where employment creation has also been held back by stagnated growth. For Saudi Arabia, a surge in the female unemployment rate is a dominant factor behind rising unemployment. While the male Saudi unemployment rate stood at 5.3 per cent in the fourth quarter of 2016, the female Saudi unemployment rate stood at 34.5 per cent. This partly reflects the rising female labour participation rate in recent years, from 12.6 per cent in 2006 to 19.3 per cent in the fourth quarter of 2016.

**Latin America and the Caribbean: Prolonged economic contraction has adversely impacted the region’s labour market**

Two years of economic contraction in Latin America and the Caribbean have had a pronounced impact on the region’s labour market. The average urban employment rate has declined steadily since early 2014 as economic activity in South America weakened substantially. At the same time, the quality of employment, as measured for example by the share of vulnerable employment, has worsened. Average unemployment in the region is estimated to have risen from 7 per cent in 2014 to 9 per cent in 2016 with a further increase projected for 2017. Brazil’s labour market has been hit particularly hard, with unemployment rising from a low of 6.2 per cent in late 2013 to 13.2 per cent by February 2017. In parallel, Brazil’s employment-to-population ratio has fallen to the lowest level since the series began in 2012. Most other South American economies have also seen unemployment increase over the past two years, albeit at a much lower rate. Recent labour market trends in Mexico and Central America have generally been more favourable although the subregion continues to face significant structural problems. Mexico’s unemployment rate fell to 3.2 per cent in March 2017, the lowest level in almost a decade. The incidence of informal work has also declined, but remains high at 57 per cent of total employment.