

PART I
Chapter 1

An Overview of Going for Growth Priorities in 2011

This initial chapter of Going for Growth identifies five structural reform priorities for each OECD country, for the European Union as a whole, and for the BRIICS – Brazil, China, India, Indonesia, Russia and South Africa. The recommendations are aimed at addressing variations in labour productivity and labour use across these countries. Moderate and high income (mainly European) OECD countries need to improve their labour use mainly by reforming their benefit and job protection systems and labour taxes. The relatively wealthy Asian member countries face a more balanced set of challenges, with a greater focus on labour productivity. The reform challenges for lower income OECD countries and the BRIICS relate to their education systems and product market regulation, as well as labour informality.

The chapter also reports the number of reform priorities that would directly and quickly improve the fiscal balance, and also estimates for most OECD countries the potential cost savings that could be reaped by implementing best practice in their national education and health care systems. It turns out that implementing many of the Going for Growth priorities could not only enhance living standards but also contribute to more balanced fiscal positions, as well as to lower global current account imbalances.

Summary and conclusions

Going for Growth reports have been published by the OECD every year since 2005. The *Going for Growth* analysis identifies five structural reform priorities for each OECD country and for the European Union (EU) as a whole.¹ This seventh edition of *Going for Growth* has been expanded to cover the four new member countries that joined the OECD during 2010, namely Chile, Estonia, Israel² and Slovenia, as well the BRIICS – Brazil, China, India, Indonesia, Russia and South Africa – key non-member countries with which the OECD works closely.³ The *Going for Growth* process provides a tool for governments to reflect on “structural” policy reforms that affect their residents’ long-term living standards. Structural policy reforms are central to the mission of the OECD, and the *Going for Growth* analysis has been used in the Mutual Assessment Process of the G20 since the Pittsburgh Summit. Since policy recommendations are only reconsidered or set every other year (in odd years), this is the fourth time that a full set of recommendations has been made for OECD member countries since the first edition of *Going for Growth* (OECD, 2005) and the first time it has been made systematically for the BRIICS. The methodology used identifies policy recommendations based on their ability to improve long-term material living standards. The reference performance measure in this regard is gross domestic product (GDP) per capita, given its contemporaneous availability and relatively broad coverage despite its potential drawbacks.⁴ Some measures that extend GDP numbers to non-market production, and thereby may come closer to indicators of well-being, are explored in Annex 1.A3.⁵ Recognising that policy reforms often pursue multiple objectives rather than just income growth, this chapter also looks at the side-effects of structural policy recommendations on two other “burning” policy objectives, namely achieving fiscal sustainability and reducing current account imbalances (see also Chapter 5).

The crisis is writ large in this year’s *Going for Growth*, vividly demonstrating the urgency of reforms in the financial sector for restoring stability and protecting living standards over the long-term (see Box 1.1).⁶ In a context of crisis recovery, priority may be given to reforms that are most conducive to short-term growth and job gains, such as reducing entry barrier regulation (e.g. in retail trade or liberal professions), administrative burdens on business and international barriers that restrict foreign direct investment (FDI). The dramatic effects of the crisis on economies globally has made many previously-identified structural policy priorities even more urgent – particularly those that would allow countries’ slack labour resources to remain in contact with the labour market. These include increasing spending on and reforming active labour market policies, reducing labour market dualism through job protection reforms or making social transfer programmes more conducive to employment. All these labour and product market reforms could help to reduce the extent of hysteresis, the process whereby jobless workers end up being unable to seek and find employment.

Main findings from the chapter include:

- Moderate and high income OECD countries face a range of policy challenges and can roughly be broken down into two groups. The first group consists primarily of continental European countries, which need to raise labour utilisation, and where reforms of benefit systems, job protection and labour taxes are common recommendations, although product market reforms also feature prominently. The remaining relatively wealthy OECD countries face a more balanced set of challenges, with a greater focus on labour productivity – especially for the Asian member countries – and with reforms of network sector regulation, FDI restrictions, tax structure and public sectors frequently recommended.
- Lower income OECD countries – including the new members – and the BRIICS face far more challenges related to their education systems and product market regulation, reforms of which are aimed at enhancing productivity levels. Labour informality also raises policy issues in these countries. In many cases, the nature of policy priorities for the BRIICS is similar in content to that for low-income OECD countries, though the amount of needed reform is typically greater in the BRIICS. Recommendations for the BRIICS and some lower income OECD countries also include in several cases reforms of legal systems and contract enforcement as well as improvements in governance systems that would address corruption.
- The current economic situation has ambiguous implications for the ability of governments to undertake reforms, with the post-crisis context making their necessity more apparent but the deteriorated fiscal positions in many countries possibly being an obstacle. Against this background, it is essential to ensure that reforms are consistent with the pressing need for fiscal consolidation. The current context of slack resource use would also favour implementing first those reforms that are known to bring stronger short-term gains, such as the removal of various barriers to competition.
- Structural reforms are mainly aimed at enhancing long-term income levels but could also yield important co-benefits for fiscal balances. For example, reforms that boost sustainable employment levels are likely to be most helpful to fiscal consolidation. The urgency of many other types of structural reforms has also increased. In particular, improvements in tax systems, or education and health care efficiency gains could ease fiscal deficits (see Chapter 6 on health).
- Structural reforms can also have important and beneficial knock-on effects on current account imbalances. Such imbalances may be affected more by some types of structural reforms than others. In this chapter, conclusions are drawn regarding different types of growth and welfare-enhancing structural reforms that would also help reduce saving-investment imbalances, depending on whether a country is in fiscal surplus or deficit, and whether it has an external surplus or deficit. For instance, in economies characterised by current account surpluses and fiscal deficits, easing product market regulations in sheltered sectors would not only boost growth but could also contribute to reduce current account surpluses by increasing investment, and to some extent help consolidate public finances; and in dual surplus countries with weak social protection, a strengthening of social benefits would enhance welfare by reducing the risk of hardship and could lower both saving surpluses (see Chapter 5 on current account imbalances).

Box 1.1. Financial market reform

The recent financial crisis and its subsequent severe impact on growth and employment have been a forceful reminder of the vital role of prudential regulation in financial markets for helping to preserve overall economic stability. Well-functioning financial sectors not only reduce the cost of producing and trading goods and services but also reduce the risks of instability. And given that financial crises generate long-lasting output losses (Furceri and Mourougane, 2009; Cerra and Saxena, 2008), enhanced stability could also contribute to higher long-term living standards. At the same time, when evaluating the current proposals and actions to strengthen prudential regulation frameworks, attention needs to be paid to preserving the well-established benefits from financial market competition. Competition matters for efficient financial intermediation, and for the pricing and quality of financial products. It can also facilitate access of firms and households to external financing and financial services, with potentially far-reaching consequences for economic growth and living standards. Fortunately, however, previous OECD analysis finds only limited trade-offs between stability and competition, and even suggests that stronger supervisors could go along with more competitive banking systems (OECD, 2010a, Chapter 6). Similarly, regulatory reform would have to strike the right balance between stability on the one hand and the cost of capital on the other. Indeed, strengthening prudential regulation might raise the long-term cost of capital with permanent adverse effects on capital accumulation and income levels. For instance, a 1 percentage point increase in core capital requirements may lead to a rise in the lending spread – the spread between bank lending and borrowing rates – by about 16 basis points, *ceteris paribus* (MAG, 2010). If reform were to raise the cost of capital in proportion with the share of bank lending in the external financing of non-financial businesses, Courneade's (2010) estimates would suggest a negative impact on potential output in the order of 0.2% in the United States and 0.6% in the euro area (assuming an offsetting monetary policy response). However, the aforementioned calculations omit the gains from the new capital framework, which include the reduced likelihood and cost of financial crises and improvements in the quality of capital allocation across the economy. These effects have been estimated to more than offset any gross costs of the new regulations, by a wide margin (BCBS, 2010).

For the BRIICS, the challenges are somewhat different. Financial markets are typically much shallower than in most OECD countries, implying low levels of financial inclusion and a more limited role for financial intermediation in capital allocation. To some extent, this reflects more stringent regulation, in particular larger barriers to entry, and higher state ownership. International evidence suggests that high state-ownership of banks tends to depress financial sector development, with negative implications for long term living standards, especially for countries with less developed financial markets (see Levine *et. al.*, 2005).

Together with actions by individual countries and the EU, a comprehensive regulatory reform is being discussed under the auspices of the G20 in recognition of the need for internationally co-ordinated rules to strengthen financial stability, in particular by reducing opportunities for regulatory arbitrage. One vital component of such a regulatory regime has been agreed in general principles, in the form of the Basel III agreement. This agreement effectively triples the size of capital reserves that banks must hold against losses over the period 2011-18, by raising the Tier 1 capital ratio from 2% to 4.5% of risk-weighted assets, and adding a further 2.5% buffer. By strengthening global capital and liquidity regulations, banks should have larger buffers to cushion downturns. These new requirements will be phased in gradually, and US and EU banks already meet them,

Box 1.1. Financial market reform (cont.)

although they may want to keep a discretionary buffer above the regulatory minima. As a result, any adverse impacts on growth over the coming years are likely to be very small, though they could reach between 0.1 and 0.6 percentage points of GDP growth per annum for Japan depending on the extent of credit-supply effects (based on MAG, 2010).

While many other details of the new financial sector reforms are still to be determined, broad consensus has been achieved on a number of principles beyond the strengthening of capital requirements (also see OECD, 2010b; 2010c; OECD, 2010d):

- Design macro-prudential policy so as to mitigate procyclical build-up of systemic risk and help alleviating the accumulation of credit-driven asset price bubbles. Develop tools to reduce the pro-cyclicality of the financial system such as contingent capital buffers with capital surcharges being applied on top of prevailing micro-prudential capital ratios, dynamic loss provisioning, or risk weights that are a function of aggregate borrowers' leverage. Establish robust institutions for macro-prudential regulation, with adequate resources and access to information to develop early warning and systemic assessment tools.
- Reduce moral hazard posed by systemically-important institutions and the associated economic damage. Options for addressing the “too-big-to-fail” problem being discussed include: targeted (or progressive) capital, leverage, and liquidity requirements; improved supervisory approaches; simplification of firm structures; strengthened national and cross-border resolution frameworks, including the development of “living wills” for major cross-border firms (see below); and changes to financial infrastructure that reduce contagion risks.
- Impose a maximum leverage ratio applicable to all types of assets. Progress on a binding standard for the leverage ratio has been hindered by a lack of international convergence in accounting standards on ending the netting of derivative positions. This lack of convergence also means that new, tighter capital requirements may have different degrees of effectiveness among countries, and, in conjunction with the risk weighting approach, entails incentives for shifting risk outside the banking system.
- Introduce cross-border crisis management mechanisms. This can be achieved by ensuring that: i) national authorities have an effective toolkit for bank resolution, harmonised as far as possible; ii) all systematically cross-border institutions have functioning stability groups, supported by regularly updated living wills; iii) burden-sharing agreements enshrined in national laws exist to limit ring fencing between countries.
- Reform non-bank financial institutions. There is the risk that tightening of bank regulation will encourage the shifting of risk to other parts of the financial sector. It is particularly important to ensure that insurance and pension fund regulations prevent build-up of systemic risk.
- Implement sound compensation practices at large financial institutions to ensure that they structure their compensation schemes in a way that does not encourage excessive risk taking.
- Strengthen accounting standards. The International and US Financial Accounting Standards Boards (IASB and FASB) have been considering approaches to improve and simplify accounting for financial instruments, provisioning and impairment recognition, and are converging, albeit slowly.

Box 1.1. Financial market reform (cont.)

In the OECD, individual countries and jurisdictions have taken initiatives to reform financial regulation to tackle the failures that led to the financial and economic crisis. Measures to strengthen framework conditions in financial markets have nevertheless proceeded at different speeds across countries, advancing faster in the United States. In particular:

- In the United States, the financial reform legislation enacted in July 2010 establishes a consumer financial protection entity, creates a systemic risk regulator (the Financial Stability Oversight Council), gives regulatory bodies the authority to determine which derivatives should be cleared through centralised clearing houses, creates a banking liquidation authority and a pre-funded liquidation fund, and bans banks from using their regulatory capital to finance some categories of risky investments (the “Volcker Rule”), in particular requesting banks to spin off part of their proprietary trading desks.
- In the European Union (EU), the authorities have decided to establish a macro prudential oversight body (the European Systemic Risk Board), and three European supervisory authorities (covering banking, insurance and pensions, and securities respectively) to set common technical standards and ensure efficient and harmonised (cross-border) supervision. Authorities have also advanced in harmonising and simplifying deposit guarantee schemes (increasing the overall level of protection), the heterogeneity of which was disruptive for financial stability during the crisis. They also intend to put in place a banking crisis management mechanism to deal effectively with the failure of European banks (including through the establishment of colleges of supervisors for large cross-border groups). As well, the European Commission has launched a consultation document to harmonise rules and tools relating to short selling across member states.
- At the national level, some EU countries have taken measures on their own. Some countries have imposed (France, Germany and Sweden) a levy on banks to reduce taxpayer costs of future bank failures and financial crises. Germany imposed a ban on naked short-selling of certain types of securities. In the United Kingdom, the authorities undertook in the second half of 2010 a three-month consultation period on a reform that intends to place both firm-specific and macro-prudential regulation (through new powers) under the auspices of the Bank of England. The new regulatory system is not expected to be in place before 2012 to allow the financial sector to adjust. Moreover, an independent commission has been given one year to report on the issue of separating retail and investment banking and the need to break-up large banks. A levy on banks will be implemented starting from January 2011 to encourage banks to move away from risky funding. Outside the EU, Switzerland imposed tighter liquidity and solvency requirements on the country’s two biggest banks, including a leverage ratio and a capital buffer that varies over the profit cycle.

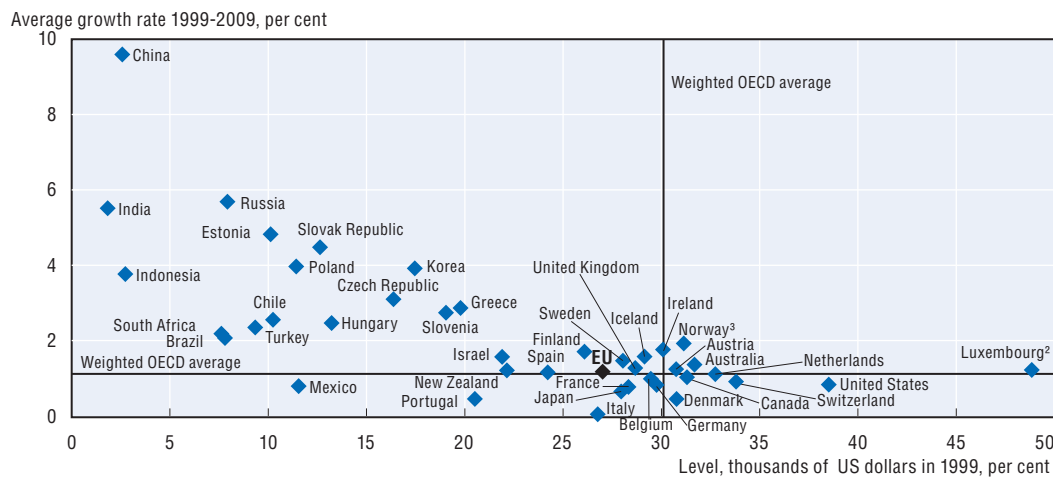
Areas where international coordination still needs to advance further include the regulation of the over-the-counter derivatives market and accounting standards. Regarding the former, it is important that authorities across both sides of the Atlantic agree on a common set of derivatives that should be traded through central clearing houses in order to avoid shopping for the most favourable set of rules. On the latter, it is important not to lose momentum in converging on global high quality financial reporting standards in spite of the postponement from June to end-2011 of the deadline for convergence fixed by the G20. Finally, international coordination of prudential supervision is particularly important for countries in a monetary union. Upgrading regulation and supervision to reduce risk in the euro area calls for an effective system of cross-border supervision and an integrated crisis management framework to reduce moral hazard.

This chapter first gives an overview of economic performance and looks at variations in labour productivity and labour resources use across the OECD countries and the BRIICS, in order to understand the relative areas of performance weakness by country. It then discusses the general orientation and focus of the policy recommendations that result from mapping performance weaknesses to policy deficiencies for each individual country. In the final parts of the chapter, the implications of growth-enhancing structural reforms for fiscal challenges and current account imbalances are addressed.

Growth performance in OECD and BRIICS countries

Examining both OECD and BRIICS countries' growth rates over the past decade compared with their income level a decade earlier (Figure 1.1) reveals that there has been some convergence in income levels. There were a number of exceptions, however, as higher relative levels were maintained by Luxembourg, Norway and to a lesser extent the United States, and some OECD countries including Italy, Mexico and Portugal had below-average growth rates in spite of starting at lower income levels. Among the BRIICS, the most rapid convergence is observed for China, India and Russia, while it has been weakest for Brazil and South Africa.

Figure 1.1. **GDP per capita levels and growth rates**¹



1. GDP per capita, in constant 2005 purchasing power parities (PPPs).
2. In the case of Luxembourg, the population is augmented by the number of cross-border workers in order to take into account their contribution to GDP.
3. Data refer to GDP for mainland Norway which excludes petroleum production and shipping. While total GDP overestimates the sustainable income potential, mainland GDP slightly underestimates it since returns on the financial assets held by the petroleum fund abroad are not included.

Source: OECD (2010), *National Accounts Database* and OECD (2010), *OECD Economic Outlook No. 88: Statistics and Projections Database*.

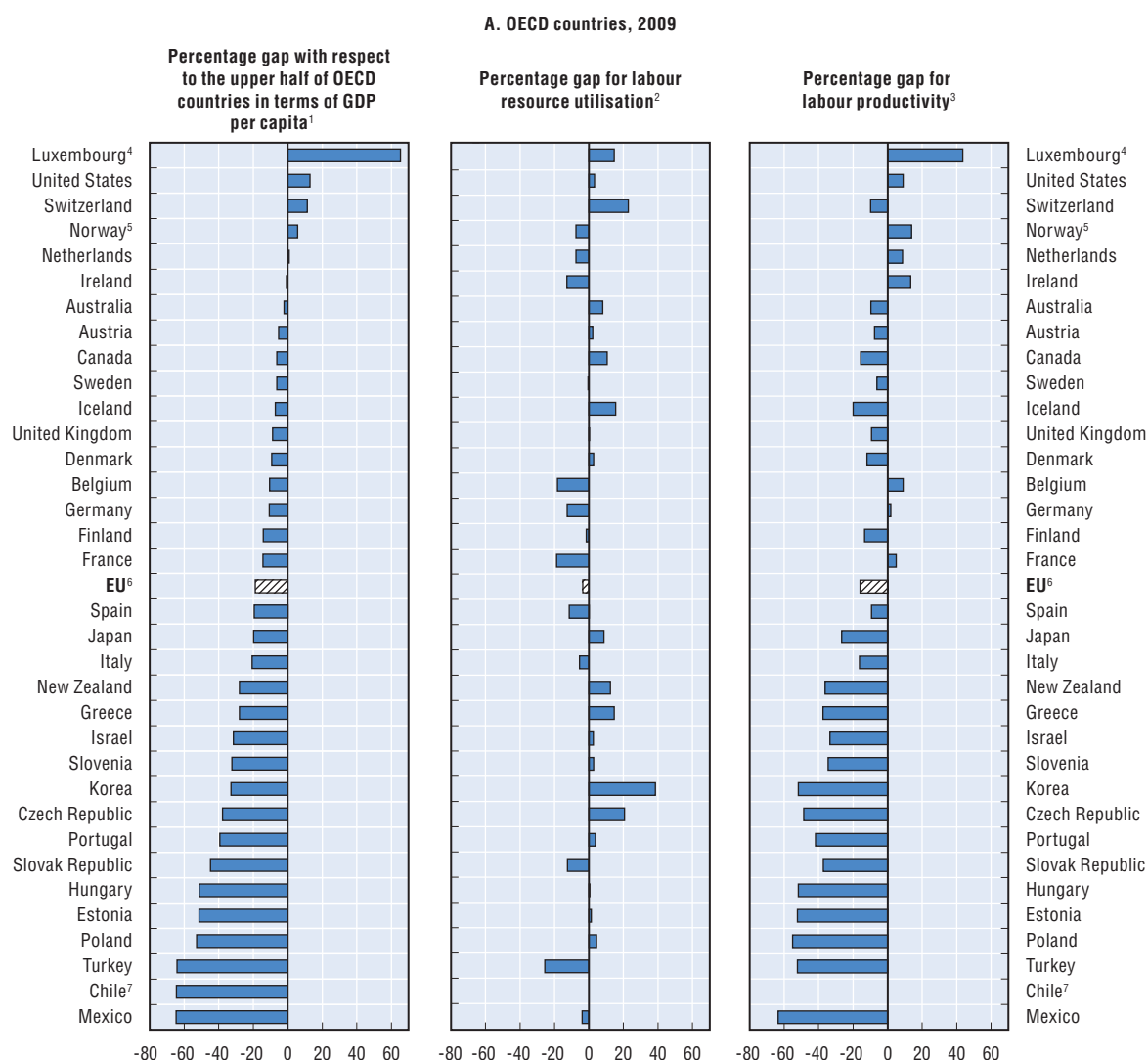
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Decomposition of GDP per capita gaps

Gaps in GDP per capita relative to the simple average of the upper half of OECD members can be decomposed into contributions from, respectively, hourly labour productivity and labour utilisation (Figure 1.2, Panel A). The decomposition reveals several different groups of countries:

- *High income/high productivity*: the highest income countries (Luxembourg, Norway and the United States in particular) typically have high productivity, although Switzerland stands out as an exception.

Figure 1.2. The sources of real income differences



- Relative to the simple average of the highest 17 OECD countries in terms of GDP per capita, based on 2009 purchasing power parities (PPPs). The sum of the percentage gap in labour resource utilisation and labour productivity does not add up exactly to the GDP per capita gap since the decomposition is multiplicative.
- Labour resource utilisation is measured as total number of hours worked per capita.
- Labour productivity is measured as GDP per hour worked.
- In the case of Luxembourg, the population is augmented by the number of cross-border workers in order to take into account their contribution to GDP.
- Data refer to GDP for mainland Norway which excludes petroleum production and shipping. While total GDP overestimates the sustainable income potential, mainland GDP slightly underestimates it since returns on the financial assets held by the petroleum fund abroad are not included.
- EU brings together countries that are members of both the European Union and the OECD. These are the EU15 countries plus Czech Republic, Estonia, Hungary, Poland, the Slovak Republic and Slovenia.
- Data on hours worked are not available for Chile.

Source: OECD (2010), *National Accounts Database*; OECD (2010), *OECD Economic Outlook No. 88: Statistics and Projections Database* and OECD (2010), *OECD Employment Outlook: Moving beyond the Jobs Crisis*.

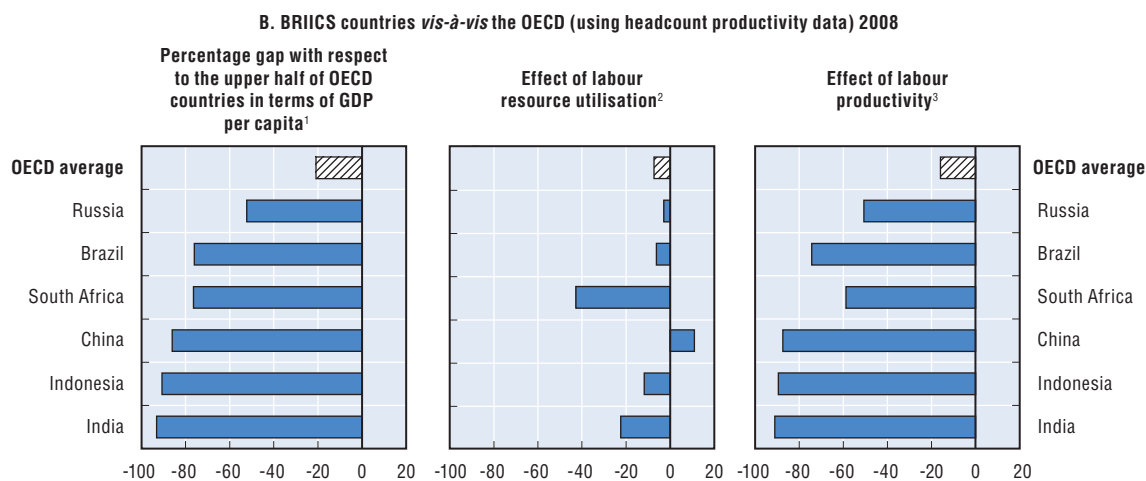
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- Average income/high labour utilisation: Australia, Canada, Greece, Iceland,⁷ Japan and Korea all have moderate to high incomes with comparatively high labour utilisation, offset by a negative gap in their labour productivity.

- *Average income/high productivity*: Belgium, France, Germany, Ireland, the Netherlands and Spain all suffer from a negative gap in their labour utilisation, offset by comparatively high labour productivity.
- *Average income/average labour utilisation and productivity*: Austria, Denmark, Finland, Sweden and the United Kingdom have similar gaps in both labour productivity and labour utilisation that explain their income levels.
- *Lower income/low productivity*: the dozen countries with the lowest GDP per capita levels face primarily productivity deficiencies, though the Slovak Republic and Turkey also face labour utilisation shortfalls.

A separate decomposition is made for the BRIICS, using headcount productivity data (Figure 1.2, Panel B). Despite rapid convergence in some of the BRIICS, all of them still have income gaps of between 60% and 90% to the upper half of OECD countries and continue to face large labour productivity shortfalls, including when compared to the average OECD country. Russia has the highest income in the BRIICS group, and its shortfall is virtually all a labour productivity gap. Among the remaining BRIICS, labour productivity shortfalls dominate except for South Africa, where labour resource utilisation is a major challenge, and to a more limited extent, India. In contrast, China has a positive gap in labour utilisation.

Figure 1.2. **The sources of real income differences (cont.)**



1. Relative to the simple average of the highest 17 OECD countries in terms of GDP per capita, based on revised 2008 purchasing power parities (PPPs) from the World Bank. The OECD average is based on a simple average of the 34 member countries. The sum of the percentage gap in labour resource utilisation and labour productivity does not add up exactly to the GDP per capita gap since the decomposition is multiplicative.
2. Labour resource utilisation is measured as employment per capita, based on KILM database estimates. In turn, employment per capita combines both the employment rate of the working-age population and the share of working-age individuals in the population. The latter reflects a demographic effect that may vary across countries and can be especially important for emerging countries in demographic transition (e.g. this factor reduces the overall employment rate in India, all else being equal).
3. Labour productivity is measured as GDP per employee.

Source: World Bank (2010), World Development Indicators (WDI) and ILO (International Labour Organisation) (2010), *Key Indicators of the Labour Market (KILM) Databases*.

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Policy reforms in the OECD and the BRIICS

Five key policy recommendations are made to enhance convergence in living standards across the OECD and the BRIICS, using quantitative performance and policy indicators to select the first three priorities, in areas where performance and policy weaknesses coincide.⁸ The remaining two priorities are made using a combination of

indicators, where available, and country-specific expertise (see Annex 1.A1 for a description of the process for identifying policy priorities). Since the set of available performance and policy indicators remains more limited for non-member countries, there is a greater reliance on country expertise for these countries.

Compared with the 2009 vintage of *Going for Growth*, a number of policy priorities for individual countries have been altered. Overall, the share of priorities that have changed is comparable with what happened in the 2009 exercise and the modifications have been more in terms of coverage than in thrust. Specifically, among the pre-enlargement OECD countries, 57 out of 155 policy priorities have been changed compared with the 2009 exercise, with 16 dropped or merged as a result of actions taken or a reconsideration of priorities. The most common shift in priorities was a broadening of their scope, which applied to 31 recommendations in 2011, compared with only $\frac{2}{3}$ rds as many in 2009. Another 10 priorities were either refocused or narrowed, to more specifically target a revised policy challenge.

The focus of the response to the economic and financial crisis on short-term stabilisation and temporary measures has reduced the emphasis on basic long-term income-enhancing reforms. While the measures taken in response to the crisis have generally supported short-term demand and mitigated the longer-term income losses from the recession, it is crucial that policymakers now turn their attention to those policy reforms that will sustainably improve incomes in the longer term. Based on both economic and political economy arguments, it might be appropriate to adapt the timing of reforms so as to maximise short-term gains. Some of the reform priorities identified here would give a quick boost to growth and jobs. In particular, the productivity and employment effects associated with the removal of various anti-competitive barriers to competition can be large even in the short to medium run. Other reforms such as those associated with education or to a lesser extent social transfer programmes would take more time to deliver their full benefits.

In most cases, pushing through reforms will also require overcoming deeply-rooted political economy obstacles to reform. Recent OECD analysis of major past reform experiences has helped identify the main ingredients for success (Box 1.2). In particular, OECD case studies and empirical analysis highlight the facilitating effect of both crises and sound public finances. In that regard, the current economic situation has ambiguous implications for the ability of governments to undertake reforms, with the post-crisis context facilitating them and weakened fiscal positions in many countries possibly being an obstacle. Economic crises often make structural weaknesses more visible, and thus may provide incentives for pursuing difficult reforms, for example of labour and product market regulation (Tompson and Dang, 2010) as well as of the tax system (OECD, 2010e). Against this background, it is essential to ensure that reforms are consistent with the pressing need for fiscal consolidation. The political acceptability of structural reform may be enhanced if the authorities commit to well-specified *ex post* evaluation mechanisms.⁹ Finally, to be accepted, structural reforms must be considered as equitable, or to be part of an overall balanced reform programme.

Overall, the balance of policy recommendations by subject area has remained quite stable for OECD countries in recent years, with the share of productivity-enhancing policy recommendations remaining at approximately 60% (Table 1.1). This ratio slightly increased in the most recent round, reflecting new priorities with respect to public sector efficiency, taxation structure, infrastructure and social mobility (grouped under “other” policy areas for the first three priorities and human capital for the last), partly following up on last

Box 1.2. Making reform happen

Going for Growth provides countries with recommendations about the structural reforms that they should consider implementing. However, the business of actually carrying out reform is complex, and involves a wide range of general political economy and more country-specific considerations. Recent OECD analysis has examined the political economy of reform in 20 country-specific case studies of reform episodes in 10 OECD countries as well as thematic treatments of the conditions that can make actual reform possible (see OECD, 2009a and 2010e). This work builds on earlier OECD work, including a chapter in the 2007 edition of *Going for Growth* that examined the issue using quantitative empirical analysis.

The review of OECD evidence suggests that a number of basic principles have often been successful (based on Tompson and Dang, 2010):

- *Governments need to have an electoral mandate for reform.* Reform “by stealth” has severe limits, and major reforms for which governments have not previously sought public approval tend to succeed only when they generate visible benefits very rapidly, which major structural reforms generally do not. While crises can create opportunities for reform surprises, sustainability is essential for real impact.
- *Effective communication by governments is important.* Major reforms have usually been accompanied by consistent coordinated efforts to persuade voters and stakeholders of the need for reform and, in particular, to communicate the costs of not reforming. Where, as is often the case, the costs of the status quo are opportunity costs, they tend to be politically “invisible”, and the challenge is all the greater.
- *Policy design should be underpinned by solid research and analysis.* An evidence-based and analytically sound case for reform serves both to improve the quality of policy and to enhance prospects for reform adoption. Research presented by an authoritative, non-partisan institution that commands trust across the political spectrum appears to have a far greater impact.
- *Successful structural reforms take considerable time to implement.* The more successful reforms in the case studies generally took over two years to prepare and adopt – and this does not include the preparation work done in the many reform episodes in which problems and proposals had been debated and studied for years before the authorities set to work framing specific reforms.
- *Cohesion of the government is important.* If the government undertaking a reform initiative is not united around the policy, it will send out mixed messages, and opponents will exploit its divisions; defeat is usually the result. The case studies suggest that cohesion matters more than such factors as the strength or unity of opposition parties or the government’s parliamentary strength.
- *Government leadership is essential.* Reform progress may sometimes be facilitated by intensive discussions involving the government and the social partners (i.e. unions and business groups) in a formalised process. However, firmness of purpose on the part of the government also seems to be a critical element of success in such situations. A co-operative approach is unlikely to succeed unless the government is in a position to reward co-operation by the social partners or can make a credible threat to proceed unilaterally if a concerted approach fails.
- *The condition of the policy regime to be reformed matters.* Successful reforms of established policy regimes often appear to have been preceded by the “erosion” of the status quo through smaller piece-meal reforms or reform attempts; where the existing arrangements are well institutionalised and popular and there appears to be no danger of imminent breakdown, reform is far more difficult.
- *Successful reform requires persistence.* A further important implication of the finding concerning reform ripeness is that blocked, reversed or very limited early reforms need not be seen as failures: they may play a role in illustrating the unsustainability of the status quo and setting the stage for a more successful attempt later on.

The OECD case studies also provide further evidence in support of some of the major findings identified by the OECD’s earlier econometric work, particularly with respect to the facilitating effect of crises and sound public finances. Finally, the case studies cast some doubt on the often-repeated claim that voters tend to punish reforming governments: the likelihood of subsequent re-election was about the same for the more and less successful reform episodes.

Table 1.1. **Distribution of Going for Growth policy recommendations by subject area**

| Going for Growth edition | Per cent | | | | | | |
|---|----------------------|------|------|------|--------------|--------|--|
| | 2005 | 2007 | 2009 | 2011 | 2011 | | |
| | Pre-enlargement OECD | | | | OECD in 2011 | BRIICS | |
| Productivity | | | | | | | |
| Product market regulation | 30 | 25 | 25 | 24 | 26 | 33 | |
| Agriculture | 5 | 5 | 5 | 5 | 4 | 0 | |
| Human capital | 10 | 14 | 15 | 15 | 15 | 17 | |
| Other policy areas | 17 | 15 | 14 | 18 | 17 | 30 | |
| <i>Total</i> | 63 | 59 | 58 | 61 | 61 | 80 | |
| Labour utilisation | | | | | | | |
| Average and marginal taxation on labour income | 8 | 7 | 8 | 8 | 8 | 0 | |
| Social benefits | 17 | 20 | 17 | 17 | 17 | 7 | |
| Labour market regulation and collective wage agreements | 10 | 12 | 13 | 11 | 11 | 10 | |
| Other policy areas | 2 | 2 | 3 | 3 | 2 | 3 | |
| <i>Total</i> | 37 | 41 | 42 | 39 | 39 | 20 | |
| Overall | 100 | 100 | 100 | 100 | 100 | 100 | |
| <i>Overall (number of priorities)</i> | 155 | 155 | 155 | 155 | 175 | 30 | |

year's *Going for Growth* edition which featured new empirical research in these domains. Some labour reform recommendations were refocused or removed, as a result of some progress in strengthening activation (see *social benefits* below). The balance of priorities between labour productivity and labour utilisation-enhancing reforms among the new member countries does not markedly change the overall composition.

For the BRIICS, four-fifths of the policy recommendations are aimed at improving productivity, reflecting these countries' relative weakness in this area. There is a strong focus on product market regulation, which is often much more stringent than in OECD countries, and education systems, where quality and achievement levels are relatively low. By contrast, compared to a number of OECD countries, where reducing support is a recommendation, there are no specific priorities on agriculture since support is relatively low. Several additional policy areas are also covered where reforms could boost productivity, including government/governance reform, intellectual property rights protection, and basic financial regulatory liberalisation. These domains are particularly important policy areas for these countries. There are fewer priorities aimed at enhancing labour utilisation, in part because most of the BRIICS have relatively high overall employment rates and less developed tax-benefit systems. Widespread informality is a greater challenge, as it can reduce economy-wide efficiency. A number of recommendations are intended to address this issue, such as relaxing overly strict job protection for permanent *vis-à-vis* other workers, containing labour costs or increasing the coverage of social protection systems.

Policy priorities to improve labour productivity performance

Product market regulation

A broad range of industry and country-level evidence illustrates the impact of product market regulation on the pace of convergence in productivity levels to technologically advanced economies (*e.g.* Bourlès *et. al.*, 2010; Conway *et. al.*, 2006). Moreover, the estimated impact of product market reform on GDP per capita is very high, with the long-term gains in

living standards realised relatively rapidly (Barnes *et. al.*, 2011; Bouis and Duval, 2011). Reflecting the importance of this type of reform, recommendations in this area are made in all but five OECD countries (Finland, the Netherlands, Sweden, the United Kingdom and the United States). This is in spite of the fact that considerable reform has been undertaken in this field in recent years. Likewise, all of the new countries in the *Going for Growth* exercise had at least one product market regulatory reform recommendation, and for many of them there were even two such recommendations. Competition policy frameworks complement product market regulation, and authorities can help to ensure that markets are competitive. A strengthening of such frameworks and/or associated competition authorities is identified as a priority for Italy, Luxembourg and South Africa.

Within product market regulation, for half of the OECD member countries and all the BRIICS except Brazil, recommendations were made to reduce economy-wide regulatory burdens. These measures include a reduction of barriers to entrepreneurship (Austria, Chile, Czech Republic, France, Greece, Hungary, Israel, Italy, Mexico, New Zealand, Norway, Poland, Portugal) through a reduction in the cost and legal barriers to entry (Czech Republic, France, Germany, Greece, Iceland, Israel), the establishment of one-stop shops or simplification of entry procedures (Chile, Italy), and easing of business exit (Chile, Czech Republic, Hungary). A further streamlining of permit and licensing systems is also needed in Estonia, Germany, Iceland, Israel and Portugal.

In the BRIICS, a similar, but much larger reduction of administrative burdens on businesses and start-ups is recommended (China, India, Indonesia and South Africa). While it may be argued that the negative effect of any particular regulatory burden is smaller than in more advanced economies, because the adverse impact on innovation incentives is less critical farther from the technological frontier (Aghion and Howitt, 2009; Bourles *et. al.*, 2010), the magnitude and scope of existing regulatory burdens are particularly large in these countries, implying that they can be highly damaging for productivity. Regulatory reforms could be aided by more systematic regulatory impact analysis (in China), to ensure that new and existing regulations are not overly costly. Complementary reforms that would reduce excessive state control and limit intervention in the operations of private firms are the subject of recommendations for several BRIICS countries. Though state ownership still appears to be excessive in some OECD countries, it is far more of an issue in China, Russia and South Africa where it appears to hurt efficiency.

Not only economy-wide but also sector-specific administrative burdens are still a problem in many industries:

- *Energy and other network sectors*: While in many OECD countries, reforms of network sectors have advanced considerably – within the EU often following European Commission directives – functional separation of supply and production in the energy sector is still identified as a priority. Beyond energy, further reform and cross-border integration of transport, postal, telecommunications and port services is a priority. Outside of the EU, restructured energy markets are also a priority in Canada, Iceland, Japan, Mexico, New Zealand, Switzerland and Turkey.
- *Retail trade and professional services*: For the EU as a whole, the full implementation of the 2009 Services Directive is a priority, with its provisions still not fully transposed into law in many member states. In retail trade, restrictions on opening hours in Belgium and Luxembourg and limits on the size or operation of larger outlets in France, Ireland, Portugal and Spain still remain an obstacle to competition, and are identified as

country-specific priorities. Professional services suffer from licensing requirements and compulsory chamber memberships that limit competition in a number of EU countries, where reforms are identified as priorities (Austria, Germany, Greece, Luxembourg, Portugal and the Slovak Republic). Beyond the EU, there has been progress in Canada to reduce inter-provincial barriers to labour mobility and competition in the skilled trades, but implementation is still lacking.

In a more limited number of OECD countries, reductions of barriers to foreign investment and ownership are identified as priorities. Restrictions in particular sectors are a concern in Canada (especially for telecom and air transport), Iceland (for fisheries and electricity), Japan (for services), Korea (for network sectors and services) and Mexico (services and infrastructure). Australia and New Zealand need to improve transparency of FDI screening procedures, while Estonia relies on a distortionary FDI grant system. Among non-member countries, a reduction of FDI restrictions (especially in services) is identified as a priority in India, Indonesia and Russia, with targeted trade barriers also being a problem in India and Russia – which introduced a particularly large number of discriminatory measures in wake of the financial crisis that have not yet been fully rescinded.

Human capital

Reforms that facilitate the accumulation of human capital are among the most important for enhancing long-run living standards, although it takes a generation for their benefits to be fully realised. One key dimension that is increasingly appreciated in the growth literature is that the quality of education is at least as important as the number of years of schooling (OECD, 2010f). Education recommendations are made for 25 OECD countries, as well as all of the BRIICS countries except Russia. These recommendations can be grouped into several areas:

- *Early and primary education*: enhancing access to, and the impact of early education programmes (Australia, Poland and the United Kingdom); improving schools' infrastructure (Greece, Mexico, South Africa); improving teacher training (Mexico, New Zealand, South Africa, the United States).
- *Secondary education*: strengthening school accountability and autonomy (Greece, Spain, Iceland, India, Mexico, Norway, Turkey, United States); improving curricula and evaluation (Brazil, Chile, Greece, Mexico, Portugal); postponing tracking (Austria, Czech Republic, Germany, Hungary, Italy, Switzerland); strengthening vocational education (Hungary, Portugal); and addressing inequalities in access (China, Indonesia, Israel, Slovak Republic).
- *Tertiary education*: increasing university autonomy (Austria, France); expanding vocational education (Brazil); introducing or raising tuition charges and, in order to alleviate their adverse effects on enrolment, combining these with income-contingent payback (Austria, Denmark, France, Czech Republic, Finland, Germany, Hungary, Israel, Italy, Slovak Republic, Slovenia, Sweden, Switzerland).
- *Social mobility*: last year's volume of *Going for Growth* examined the extent to which education policies (and tax and benefit systems) may affect social mobility, which can enhance entrepreneurship, the overall quality and allocation of human capital, work incentives and ultimately productivity. The United States is one of several OECD countries that do not do well on this account (Causa and Johansson, 2009), and reforms to improve equality of opportunity are identified as one of the top five priorities. These measures include strengthening early childhood education and enhancing the social mix in classrooms.

The costs of some education reforms are a concern at a time when the vast majority of OECD countries are contemplating fiscal consolidation. However, there can be considerable cost efficiencies to be had within many countries' education systems while maintaining, or even raising, output levels. This issue, and the potential scope for cost savings, is discussed at greater length in the fiscal section below.

Agriculture

Very little progress has occurred in reducing agricultural subsidies, especially with the closure of the Doha round of international trade negotiations being delayed so long. Producer support levels have fallen somewhat as a mechanical result of higher world market prices of agricultural commodities, but less so as a result of substantial reforms. Recommendations were renewed in this area for Japan, Iceland, Korea, Norway, Switzerland, the United States as well as the EU, who all need to further reduce the level of producer support and to de-link it from production (especially Japan and Korea) to mitigate its adverse effects on the efficiency of resource allocation. Biofuel subsidies entail high (implicit) carbon prices compared with other greenhouse gas mitigation instruments, and certain first-generation biofuels may in fact be carbon-intensive. Subsidies should therefore be reduced in the EU and the United States, while tariffs on imported ethanol should be removed.

Housing policies

Housing policies can affect both labour productivity and labour utilisation. Depending on country-specific circumstances, reforms in the housing area are considered to improve either of these two dimensions of overall economic performance.¹⁰ Restrictive housing policies such as rent regulation can limit labour mobility, impede the smooth functioning of labour markets and potentially raise structural unemployment, especially in the current recovery context where reallocation of labour across different sectors and regions is needed in a number of OECD countries. A special chapter on this topic is included in this volume (Chapter 4). Overly stringent planning and zoning can raise house price levels and volatility, and thereby contribute to financial and economic instability as well as undermine competition and productivity in certain sectors such as retail trade. Housing policies and rent regulation need to be revised in Denmark, Estonia, Luxembourg, the Netherlands, Poland, Slovak Republic, Sweden and the United Kingdom. In China, the only partial implementation of rural land management regulations deters permanent migration and thereby reinforces urban-rural distortions that hamper geographic mobility and ultimately overall productivity.

Other policy areas

A number of additional policy areas are identified as key priorities to boost labour productivity which apply more often to OECD countries but also in some cases to the BRIICS:

- *General taxation*: as highlighted in the 2009 edition of *Going for Growth* (OECD, 2009b), the structure of taxation can lead to distortions in the incentives to save, work and invest, reducing economy-wide productivity and labour input. Policy recommendations to improve the efficiency of the tax system are featured for Australia, Canada, Greece, Hungary, Italy, Japan, Korea, Portugal and the United States. These include the reduction of corporate taxes (Australia, Italy and Japan), as well as more general guidance to shift

the structure of taxation toward consumption (and immovable property), which can raise GDP per capita. An introduction of an integrated nationwide value-added tax (VAT) system is recommended for Brazil and the United States – where the mortgage interest deduction and (limited) health insurance tax exclusion also still need to be reduced. Policies to reduce tax evasion as well as to broaden the tax base are advocated in several countries (Greece, Hungary, Italy, Korea and Portugal) as a way to reduce distortions while enhancing revenue.

- *Public sector reform*: reforms to improve the efficiency of government expenditure are a priority for the Czech Republic, Finland, Hungary, Iceland and New Zealand. Increased use of benchmarking is recommended in Finland, Iceland and New Zealand.¹¹
- *Public infrastructure*: enhancing the capacity of transport systems – primarily roads – is a priority in four member countries, and this requires better selection of infrastructure projects in Australia, more effective user charges in Ireland and the United Kingdom, and a general upgrading in Poland. Better pricing and management of water and sewage treatment are identified as priorities in Australia and Ireland, while telecommunications infrastructure is a priority in Poland. Infrastructure provision levels are still low in many non-member countries, and an increase in investment is recommended in Brazil and India. While raising spending is an important part of this challenge, a reform of the regulatory environment for infrastructure would help to attract private investment and optimise use, notably in Indonesia.
- *Health care*: improving the cost effectiveness of the health systems is a priority in Switzerland and the United States, with excess expenditure the main challenge. Health care is also a priority for Russia, but the problem to be overcome is that there is low quality and output efficiency, with insufficient funding, weak incentives and poor outcomes.
- *Innovation*: innovation-related reforms boost productivity both by advancing the technology frontier (mainly in advanced OECD economies) and by speeding up the absorption of existing technology (in less advanced OECD and non-member countries).¹² Specific recommendations are made to redirect public funding towards those R&D support programmes that have the highest expected returns (Ireland and Canada), increase R&D tax incentives where they are currently low (New Zealand), improve access to venture capital (Slovak Republic) and strengthen collaborations between academia and industry (Ireland). Broader reforms to the science sector could strengthen innovation and absorption in Russia, while better intellectual property rights enforcement would help improve incentives for investments (often involving technology transfers) in new products in China.
- *Financial services*: Financial market reform is in general not featured among the five priorities and is treated separately, as it is an urgent challenge in many OECD countries that requires broad international co-ordination, as discussed in Box 1.1 and last year's edition of *Going for Growth*. More basic financial liberalisation needs to take place in most non-member economies, including Brazil and India, where bank credit is not fully allocated by the market, and reforms are a priority. However, in order to deliver their full benefits, such liberalisations should be gradual and accompanied by strong prudential regulation.

In non-member countries, a number of additional policy areas stand out as particularly relevant, as highlighted in the 2010 *Going for Growth* special chapter on the BIICS. Beyond the domains already mentioned above – notably product market reform,

infrastructure, education, health care, innovation and financial services – some other areas are more important for these countries:

- *Governance and legal reforms*: reform priorities in these areas have been made previously for some OECD countries (e.g. Mexico) to strengthen the “rule of law” and clarify property rights. Such a recommendation is a common challenge among many non-member countries, and a strengthening of contract enforcement and some improvement in the effectiveness of courts is recommended in China to improve the predictability of the business environment, and to better protect intellectual property rights. Institutional reforms that would help to fight corruption are advocated for Indonesia and Russia, including a simplification of administrative regulations and a reduction in the extent of bureaucratic discretion.
- *Subsidies*: energy subsidies are sometimes used as social policy devices but they distort markets and waste resources that could more effectively be targeted directly at the poor – such as through cash transfers – or at growth-promoting spending. Phasing out such subsidies is a priority for India and Indonesia in particular.

Beyond the above areas, there may be some policy areas which the exercise does not yet cover which could be of considerable importance for improving living standards in the BRIICS, as discussed in the special chapter in the 2010 edition of *Going for Growth*. The design of the exercise is such that there is a necessary focus on policy areas where quantitative indicators provide coverage, and are thus able to reveal policy priorities. New empirical work that uses aggregate growth regressions to look at a broad range of growth drivers for OECD and BRIICS countries is provided in Bouis *et. al.* (2011). This analysis largely confirms previous OECD findings regarding the sources of growth for a smaller set of OECD countries, and also brings new insights. In particular, the strength of patent rights protection appears to be a robust determinant of long-run productivity levels once controlling for the impact of all other policy and institutional influences. Priority areas may evolve, and new ones emerge in the future as a result of further empirical analyses.

Policies to enhance labour utilisation

Labour market outcomes vary considerably across OECD countries and the BRIICS. The unprecedented recession brought about substantial labour market adjustment everywhere, but developments in both participation and employment rates diverged strongly across countries (Figure 1.3).¹³ Indeed, in contrast with earlier recessions, participation rates actually increased in many countries, in part due to the entry of second earners into the labour market, and because seniors delayed retirement owing to a decrease in their pension savings, or to past reforms to both pension and early retirement systems. Nevertheless, there are concerns for youth, who may suffer long-term consequences of unsuccessful labour market entry, and the risk of labour market withdrawal remains for older workers. In fact, as a result of the sizable job losses in many countries (notably the Czech Republic, Greece, Ireland, Portugal and Spain, see Table 1.2), a substantial risk of persistent high unemployment exists. This is also the case in a number of continental EU countries where job losses have been smaller but labour market institutions remain less employment-friendly despite the reforms of recent years (which have followed, to some extent, the *OECD Jobs Strategy*). In some countries, these problems can be compounded with a shift toward the informal sector. *Going for Growth* priorities are mainly aimed at raising labour utilisation over the long term, and many would also help

Figure 1.3. Labour force participation and unemployment rates



1. 2008 for Brazil, Indonesia and South Africa and 2007 for China.

Source: OECD (2010), OECD Economic Outlook No. 88: Statistics and Projections Database and ILO (International Labour Organisation) (2010), Key Indicators of the Labour Market (KILM) Databases.

Table 1.2. **The estimated vulnerability to an increase in structural unemployment varies by country**

| Estimated relative sensitivity of structural unemployment to a cyclical increase in aggregate unemployment ² | Change in unemployment rates activity from peak to mid-2010 ¹ | | |
|---|--|--|--|
| | No/small unemployment impact (Less than a 1.5pp increase) | Medium-small unemployment impact (At least a 1.5pp increase but less than a 3pp increase) | Large unemployment impact (At least a 3pp increase) |
| Low | Korea | Canada Mexico New Zealand Sweden | Denmark Iceland United States |
| Medium | Australia Austria Germany Japan Luxembourg Norway | Finland France Hungary United Kingdom | |
| High | Switzerland | Belgium Italy Netherlands Turkey | Czech Republic Greece Ireland Portugal Spain |

Note: pp: Percentage-point.

1. Peak defined in terms of real quarterly GDP.

2. Based on OECD estimates of how the impact of recessions on structural unemployment is affected by cross-country differences in labour market institutions and policies (see Guichard and Rusticelli, 2010).

Source: OECD calculations based on OECD Economic Outlook No. 87, Table 5.2.

alleviate the persistent labour market effect of the crisis. Policy priorities to address labour utilisation include tax policies, the design of social transfer programmes and labour market regulation.

Average and marginal taxation of labour income

High average and – in particular – marginal taxes on labour incomes can reduce workforce participation and raise unemployment, especially for workers with low incomes. High marginal tax rates have also been found to reduce weekly hours worked of second earners (Causa, 2009). Lowering such taxes (including through cuts in social contributions) is a priority for almost half of OECD countries (Australia, Austria, Belgium, the Czech Republic, Denmark, Germany, Greece, Finland, France, Hungary, Israel, Italy, the Netherlands, Norway, Sweden and Turkey).¹⁴ However, given the substantial fiscal challenges that many of these countries face, it will be important for them to pursue efforts in that direction only gradually and along with base broadening, public spending efficiency gains or outright cuts, as well as shifts in the structure of taxation more towards growth-friendly forms of taxation, such as taxes on consumption, immovable property or pollution. Outside of the OECD, labour taxes are generally lower, and thus pose less of a disincentive to work, though they are high enough in Brazil that reducing them is a priority.

Social benefits

Restructuring benefit systems is a particular challenge in the post-recession context due to the heightened risk of unemployment persistence and early withdrawal from the labour force. Embedded features of pension systems – such as the eligibility age for benefits, the extent of actuarial adjustments for early and late retirement and the existence of formal or effective early retirement schemes – have powerful effects on

decisions to remain in the labour force. Reforms that move pension systems closer to actuarial neutrality are identified as priorities in Austria, Belgium, Finland, Greece, Hungary, Luxembourg, Slovenia, Spain, Poland and Turkey. Phasing-out early retirement schemes is recommended in Belgium, France, Greece, Luxembourg, Poland and Turkey, and effective retirement ages need to be raised more broadly. However, a tightening of some early exit routes from the labour market risks triggering an increase in the use of others, including disability and sickness benefits. While there was some success in limiting new inflows to these schemes prior to and in the wake of recession, persistently high unemployment will add renewed pressure on systems that do not enforce strict health criteria for eligibility and have insufficient monitoring. Better monitoring of eligibility for disability schemes is a priority in Sweden, while more frequent reviews of work capacity are a priority in the Denmark, the Netherlands, Norway and the United Kingdom.

Unemployment benefit systems have been an important device for mitigating the income losses caused by the crisis, and several OECD countries extended coverage, raised the level and/or lengthened the duration of benefits, especially where these were comparatively low. However, too-high or long-lasting unemployment benefits reduce job-search incentives and can raise wages above market-clearing levels, thereby increasing structural unemployment. Unemployment insurance reform is a priority in Belgium, Canada, Finland, the Netherlands and Portugal. In these countries, stricter limits on benefit duration or a reduction in their level over the unemployment spell are recommended. Relatively generous unemployment benefits can also be made more consistent with low unemployment through well-designed active labour market programmes and strong job-search requirements. This may be particularly important in view of the labour reallocation needed in wake of the crisis. A revision of these activation policies to strengthen their effectiveness is a priority in Estonia, Ireland, Israel and Luxembourg.

Beyond tax policies and the design of benefit systems, broad access to childcare and appropriate parental leave policies are important to facilitate female labour force participation. A strengthening of childcare programmes and related policies is a priority for Australia, Chile, Ireland, Korea, the Slovak Republic and Switzerland.

Labour market regulation and wage policies

Poorly designed labour market regulations create duality in the labour market, which refers to the existence of separated segments where comparable workers enjoy differential wage and protection treatment. In particular, duality often results from excessive gaps in job protection between permanent and temporary contracts. This hampers employment of certain groups (*e.g.* young people) and overall productivity (OECD, 2006b; Bassanini *et al.*, 2009). Further reforms to reduce labour market duality through a reduction in the protection of permanent jobs are a priority in Chile, the Czech Republic, France, Germany, Italy, Japan, Korea, the Netherlands, Portugal, Spain, Slovenia and Sweden. Easing very stringent restrictions on temporary contracts is a priority in Luxembourg and Turkey. Collective dismissal provisions are also a problem in India, where larger plants face especially onerous *pro forma* requirements. To tackle the problem of informality, simplifying dismissal procedures and reducing severance payments is identified as a priority in Indonesia. The positive effects of job protection reforms can be further reinforced through concomitant introduction or appropriate strengthening of unemployment benefit or insurance systems where these are little developed, as recommended for Chile and Indonesia.

High minimum labour costs, which can result from a combination of high legal minimum wages and/or labour taxes, can further limit the jobs available for young workers and the low-skilled. This can also be a problem in countries with informality problems, although minimum wages can also help attract workers to the formal sector. In order to address excessive labour costs, France, Greece, Indonesia, Slovenia and Turkey should limit the increase in their minimum wages.

The cost of labour is also driven up by collective wage agreements that in some countries are administratively extended to workers and employers who are not party to the original settlements, leading to too-high labour costs for some employers (who may sometimes be in different sectors and regions) and reducing competitive pressures from the entry of new firms. Greater flexibility in wage determination is a priority in Belgium, Italy, Slovenia and Spain. In South Africa, a greater degree of coordination of wage bargaining could help to raise the very low employment rate in the formal sector.

The contribution of structural reforms to fiscal sustainability

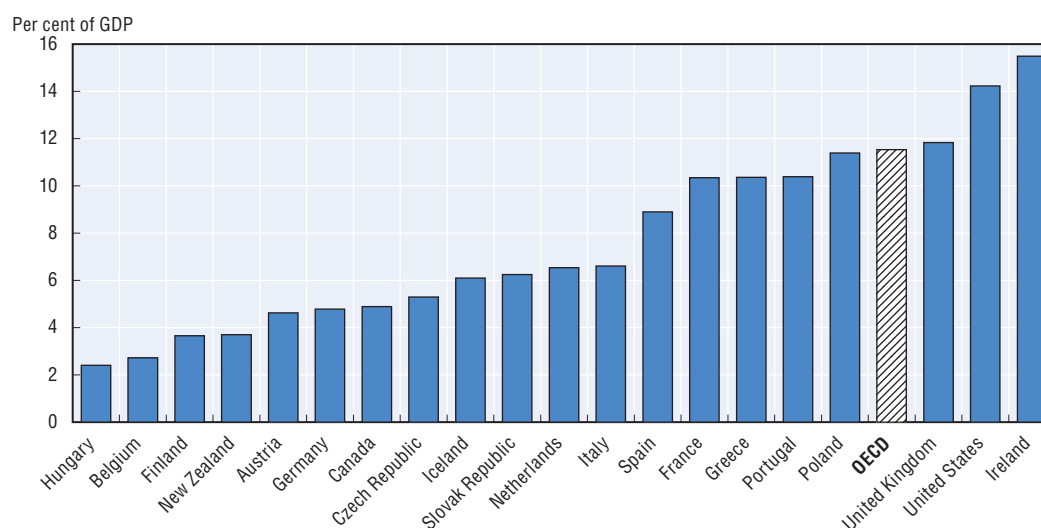
The structural reforms recommended in *Going for Growth* are directed at improving long-term levels of GDP per capita. However, most reforms have important side effects that could improve or worsen fiscal balances. This is of particular importance at the present juncture given the wide post-crisis fiscal deficits. Against that background, this section examines the extent of co-benefits for public budgets from various structural reforms to boost long-term output.

Fiscal deficits loom large

Fiscal deficits and government debt are approaching record levels. Fiscal deficits are estimated to have amounted to 8% of GDP in OECD countries in 2010 – more than three-quarters of which is estimated to be structural – and debt-to-GDP ratios will continue to rise across the OECD area, exceeding 100% of GDP on average in 2011 (OECD, 2010c). This rising indebtedness in OECD countries could jeopardize future income growth, directly through its effects on long-term interest rates and the ability to counteract future crises, and indirectly by making political support for growth-friendly reforms more difficult (Duval, 2008; Tompson and Dang, 2010). Reduction of fiscal deficits is therefore a crucial policy challenge for OECD countries. A stylised extension to 2025 of OECD's short-term projections (OECD, 2010c, Chapter 4) has been used to assess the extent of consolidation needed to reduce debt-to-GDP ratios by 2025. The scenario assumes that from 2012 onwards there is a gradual and sustained improvement in the underlying primary balance until the debt-to-GDP ratio is reduced to 60% of GDP in each country.^{15, 16} Measured against this criterion, the extent of consolidation needs varies widely across the OECD, with three groups of countries emerging (Figure 1.4):¹⁷

- *Very large fiscal consolidation needs* (more than 6% of GDP relative to 2010): the reduction of the debt-to-GDP ratio would call for an increase in underlying primary balances of more than 10% of GDP in Greece, France, Ireland, Japan, Poland, Portugal, the United Kingdom and the United States. The required change ranges from 6% to 10% of GDP in Iceland, Italy, the Netherlands, Spain and the Slovak Republic.
- *Moderate to large fiscal consolidation needs* (lower than 6% of GDP relative to 2010): the reduction of the debt-to-GDP ratio would require an increase of underlying primary balances of less than 4% of GDP for Belgium, Finland, Hungary and New Zealand. The need for fiscal consolidation ranges from 4% to 6% in Austria, Canada, the Czech Republic and Germany.

Figure 1.4. **Required improvement in the underlying primary deficit (from 2010 onwards) to achieve a debt-to-GDP ratio equal to 60% of GDP by 2025¹**



1. The chart shows the total consolidation effort required to achieve a gross general government debt-to-GDP ratio equal to 60% of GDP by 2025. It assumes a constant improvement in the underlying primary balance each year projected between 2013 and 2025, calculated so as to achieve the debt target in 2025 and based on the improvement projected in each country between 2010-12. The required consolidation effort for Japan to achieve a debt ratio of 60% of GDP is not shown because it would call for a very large degree of tightening if this were to be achieved by 2025.

Source: OECD (2010), OECD Economic Outlook No. 88, Vol. 2010/2.

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- **Low fiscal consolidation needs:** a third group of countries has comparatively low fiscal consolidation needs. Within the OECD, countries such as Australia, Denmark, Korea, Luxembourg, Norway, Sweden and Switzerland do not need to implement fiscal consolidation in order to achieve the 60% debt-to-GDP ratio in 2025, due to their more favourable initial conditions.

Public finances in the BRIICS and new OECD members are also generally more sustainable than in most OECD countries, reflecting the comparatively low level of their debt-to-GDP ratios, their moderate primary deficits and/or their relatively strong growth prospects. This is especially the case for China and Indonesia where the general government debt is below 30% of GDP and fiscal deficits are small (respectively, 1.2% and 1.6% of GDP in 2009). South Africa and Russia have comparatively higher headline deficits (amounting to respectively 7.6% and 5.3% of GDP) but also enjoy debt-to-GDP ratios below 30%.¹⁸

Structural reform can assist consolidation

Given the size of fiscal imbalances and the need to preserve confidence and credibility, many OECD countries appropriately plan to begin a process of consolidation from 2011. Such efforts could be aided by the implementation of structural reforms. Generally, structural measures that raise potential output through higher labour utilisation are likely to contribute more to fiscal consolidation than measures which work through the productivity channel. Higher employment is often associated with higher tax revenue and lower public spending on benefits. Overall, a 1 percentage point improvement in potential

employment through structural reforms would improve the fiscal position across OECD countries by between 0.3 to 0.8 points of GDP (OECD, 2010c). Higher productivity is likely to be reflected into higher public sector wages or higher social benefits,¹⁹ and therefore to deliver comparatively smaller fiscal gains. Historical experience also suggests that fiscal consolidation is more likely to be achieved through cuts in spending than raising taxes, possibly because this demonstrates commitment and strengthens the credibility of the consolidation strategy (Alesina and Ardagna, 2009; Guichard et. al., 2007).

Although fiscal consolidation should not be obtained by compromising long-term growth-friendly structural reforms, the magnitude of the immediate fiscal challenge in some countries may still constrain reform choices in practice. Countries with large fiscal consolidation needs (e.g. Ireland, Japan, Poland, Portugal, the United Kingdom and the United States) may be forced to favour policies that are likely to directly improve their fiscal balances over the coming years. Consequently, they may give priority to reforms which boost employment and reduce public spending at the same time. By the same token, these countries have less room to boost public spending on productivity-enhancing areas like education, innovation and infrastructure – which of course does not imply that progress cannot be made in these areas through other means.

Overall, six stylised categories of structural reforms can be distinguished depending on their effect on fiscal positions (positive directly or indirectly, or negative) and on whether they boost long-term GDP per capita by raising employment or productivity (Table 1.3).²⁰ Four of these categories, which are reviewed in detail below, could contribute to both raise long-term living standards and consolidate public budgets. These are reforms that would enhance fiscal positions either directly, by reducing public spending, or indirectly, by gradually increasing tax receipts through higher productivity and – especially – employment. Reforms that ultimately increase productivity and/or employment, but would first weaken fiscal positions by increasing growth-friendly public spending (e.g. on innovation, infrastructure or education) or by reducing tax receipts (e.g. tax wedge cuts) are not discussed below. Their cost for public budgets would only gradually and partially be reduced as they deliver their benefits for productivity and employment.

Reforms that increase employment and directly improve fiscal positions

Reforms of disability, sickness and unemployment benefit schemes, as well as of old-age pension systems and *de facto* early retirement schemes could contribute to immediately improve fiscal balances while fostering employment and thereby raising tax revenues in the longer term. Such reforms include *inter alia* tighter eligibility criteria to disability benefits, cuts in the level and/or duration of unemployment benefits or increases in minimum retirement ages. Such reforms are identified as key priorities in almost three-quarters of the 40 countries considered in *Going for Growth*.²¹ The crisis has already led to an increase in labour force participation in a number of countries, which reforms in these areas could help consolidate. Phasing out crisis-related increases in benefit levels and/or duration (where these were already high) as unemployment goes down would also raise labour utilisation with direct co-benefits for public budgets. By contrast, some of the recent extensions in the coverage of unemployment benefits in countries where systems did not previously cover an important share of the workforce, – particularly temporary workers – could be made permanent.

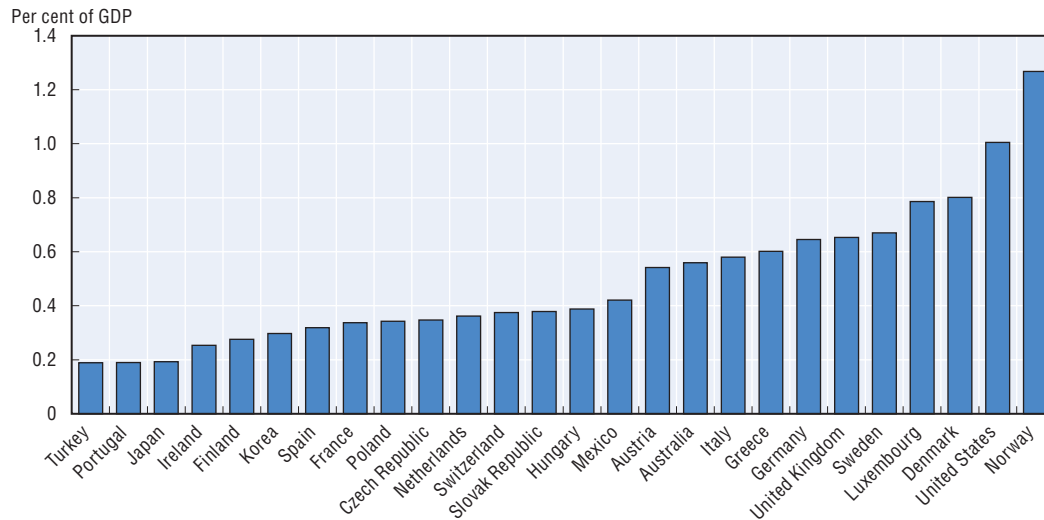
Table 1.3. **Fiscal impact of various types of growth-enhancing structural reforms**

| A. Reforms that directly improve fiscal positions | |
|--|--|
| Productivity-enhancing reforms | Improve public spending efficiency in particular in: |
| | Health care |
| | Education |
| | Reduce the scope of state control |
| | Reduce public subsidies (producer support to agriculture, energy subsidies) |
| | Reduce housing subsidies |
| | Implement taxes on negative externalities such as pollution (e.g. carbon emission pricing, green taxes) |
| Employment-enhancing reforms | Reconsider schemes undermining incentives to work |
| | Monitor better the disability and sickness benefits schemes |
| | Reduce unemployment benefits levels and/or duration |
| | Phase out early retirement schemes and/or increase legal retirement age |
| B. Reforms that improve fiscal positions only indirectly | |
| Productivity-enhancing reforms | Relax product market regulation |
| | Ease entry restrictions in non-manufacturing sectors |
| | Reduce barriers to entrepreneurship |
| | Reduce barriers to trade and FDI |
| | Implement revenue-neutral changes in tax structure |
| | Increase the share of consumption and property taxes and reduce the share of corporate and labour income taxes |
| | Broaden the tax base and cut the tax rate |
| Employment-enhancing reforms | Relax employment protection legislation |
| | Reduce legal minimum wages where high and/or for specific groups |
| | Relax product market regulation |
| C. Reforms that are likely to weaken fiscal positions at least in the short run | |
| Productivity-enhancing reforms | Increase public spending on innovation, education, infrastructure |
| | Reduce international trade barriers (tariffs) |
| Employment-enhancing reforms | Increase public spending on active labour market policies |
| | Reduce the tax wedge on labour income |

Reforms that increase productivity and directly improve fiscal positions

Efficiency gains in public spending.²² Public spending efficiency is a key policy area where reforms could allow for reduced expenditure, while maintaining or even increasing outputs.²³ In particular, improving the efficiency of education systems is a key policy objective in almost all OECD countries and the BRIICS.²⁴ Recent OECD analysis suggests that substantial fiscal resources could potentially be saved in underperforming countries through the gradual adoption of best practices in primary and secondary education, which as a whole currently cost about 3% of GDP on average in OECD countries (Sutherland *et. al.*, 2007).²⁵ The estimated potential cost savings with no prejudice to education outcomes amount to 0.2% to 0.4% of GDP for most countries, even reaching 0.6% to 1.3% of GDP for Denmark, Germany, Luxembourg, Norway, Sweden, the United Kingdom and the United States (Figure 1.5). Reforms in this area may include *inter alia* the possibility for pupils and/or their families to choose between schools (therefore making schools more responsive to needs), a definition of performance objectives for public educational institutions along with incentives to reach them, and a decentralisation of responsibilities for primary and secondary education to sub-central governments (OECD, 2008, Chapter 4).

Figure 1.5. **Potential cost savings (public and private) from efficiency gains in primary and secondary education at the national level**^{1, 2}



1. Potential savings represent the difference between a no-reform scenario and a scenario where all schools in each country would become on average as efficient as those in the best performing country. Estimates of efficiency are based on DEA analysis at the national level with two outputs (average Programme for International Student Assessment – PISA score and homogeneity of PISA score) and two inputs (teachers per 100 students and socio-economic background of students).
2. Potential input cuts applied to compensation of all staff in primary, secondary and post-secondary non-tertiary education in 2002.

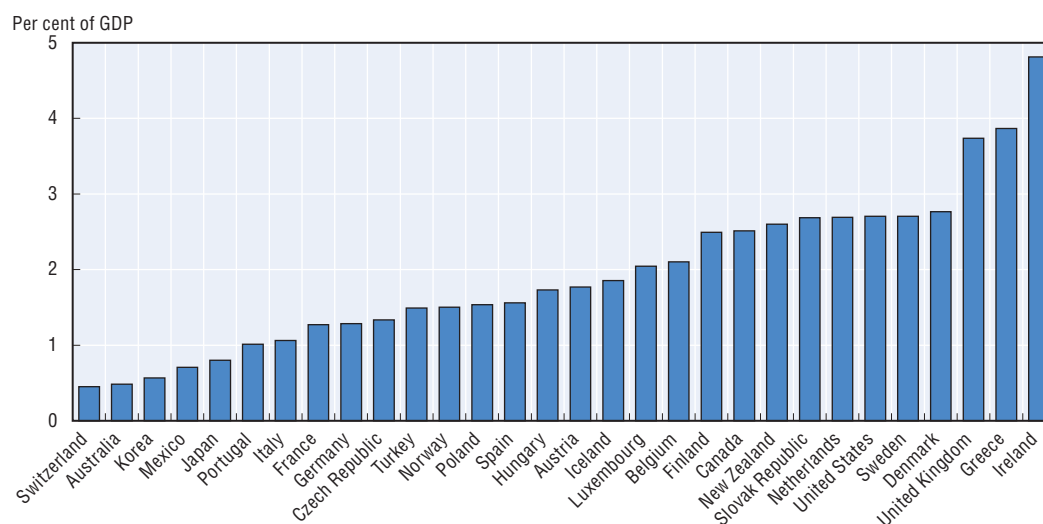
Source: OECD calculations; OECD (2005), *Education at a Glance*, OECD indicators 2005.

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Improving health care sector efficiency could deliver even larger fiscal gains, and it appears as a key priority for the Czech Republic, Russia, Switzerland, the United Kingdom and the United States. More generally across OECD countries, efficiency gains hold the promise of sizeable cost savings given that overall health care spending accounts for about 9% of GDP on average (6% when considering only public spending). Potential savings are estimated here as the reduction in public spending that could be achieved by moving towards the efficiency levels of best-performing countries while improving health outcomes – as measured by life expectancy gains – at a similar pace as over the past decade.²⁶ Such savings in public expenditure could amount on average to about 2% of GDP, and they appear particularly sizeable for Greece, Ireland and the United Kingdom (Figure 1.6).

Pricing pollution and reducing public subsidies and tax expenditures. Cost-effective policies to address public “bads” such as pollution could also enhance welfare – although not GDP per capita – while assisting fiscal consolidation. Pollution pricing mechanisms such as green taxes or auctioning of emission permits should generally be preferred to green subsidies, as the latter increase budget deficits and are not cost-effective tools to address environmental issues more broadly. Revenues from environmental taxes vary widely across countries (Figure 1.7). They remain low in countries such as Canada, Chile, New Zealand or the United States, implying some apparent scope for raising further revenues from this source. In particular, the potential fiscal revenues from pricing greenhouse gas emissions is sizeable, and has been evaluated for instance at 2.5% of GDP on average by 2020, if all industrialised countries were to use domestic carbon taxes or auctioned emission trading permits to reduce emissions in each of them by 20% relative to 1990 levels (De Serres *et. al.*,

Figure 1.6. **Potential fiscal gains from efficiency improvements in health care systems**¹

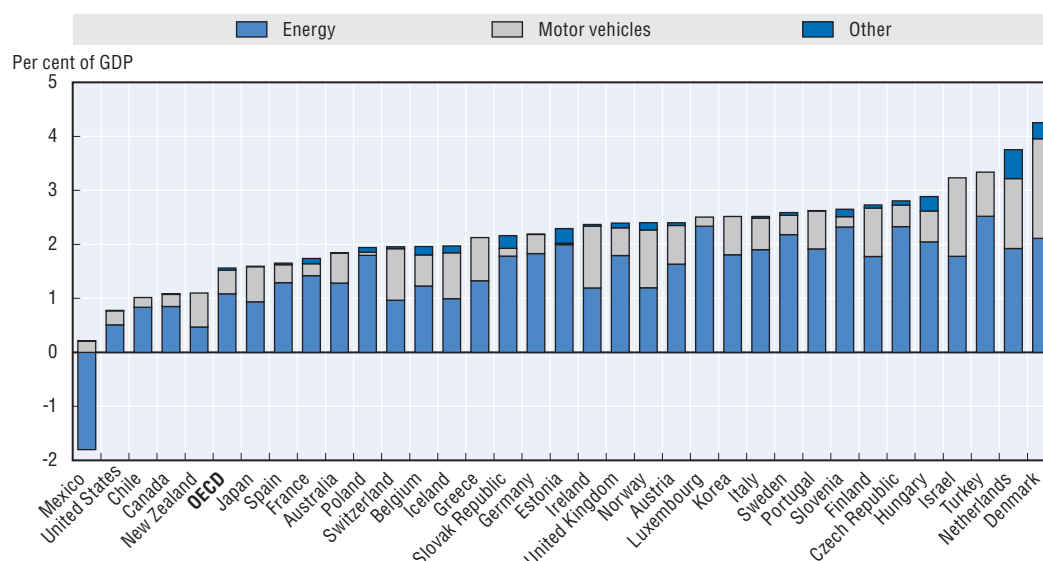


1. Potential savings represent the difference between i) a scenario where public spending and life expectancy gains would increase at the same pace over the next decade as over the decade 1997-2007 and ii) a scenario where countries would achieve similar health improvements with lower public spending by moving towards the efficiency levels of best-performing countries.

Source: See Chapter 4; OECD estimates based on Joumard et al. (2008), "Health Status Determinants: Lifestyle, Environment, Health Care Resources and Efficiency", OECD Economics Department Working Papers, No 627.

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Figure 1.7. **Revenues from environment-related taxes, 2008**



Source: OECD/EEA Database on instruments used for environmental policy.

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2010). In the EU, the planned gradual auctioning of emission permits is expected to raise a growing amount of revenues from 2013. Opportunities to raise additional receipts emerge also from the existence of disparities in environmental-related tax rates within countries

(OECD, 2009c). Such disparities reduce the efficiency of green taxation as they do not generally reflect differences in the magnitude of negative externalities.

Public subsidies, when not addressing market failures, distort resource allocation and hurt productivity. Subsidies across the OECD range from about 0.1% of GDP in Greece to 3.9% of GDP in Switzerland.²⁷ Reducing producer support to agriculture is identified as a country-specific priority in the EU, Iceland, Japan, Korea, Norway, Switzerland and the United States; reducing subsidies to energy appears as a recommendation in Indonesia, and phasing out housing subsidies (or tax expenditures in this area) is a priority in Denmark and Luxembourg.

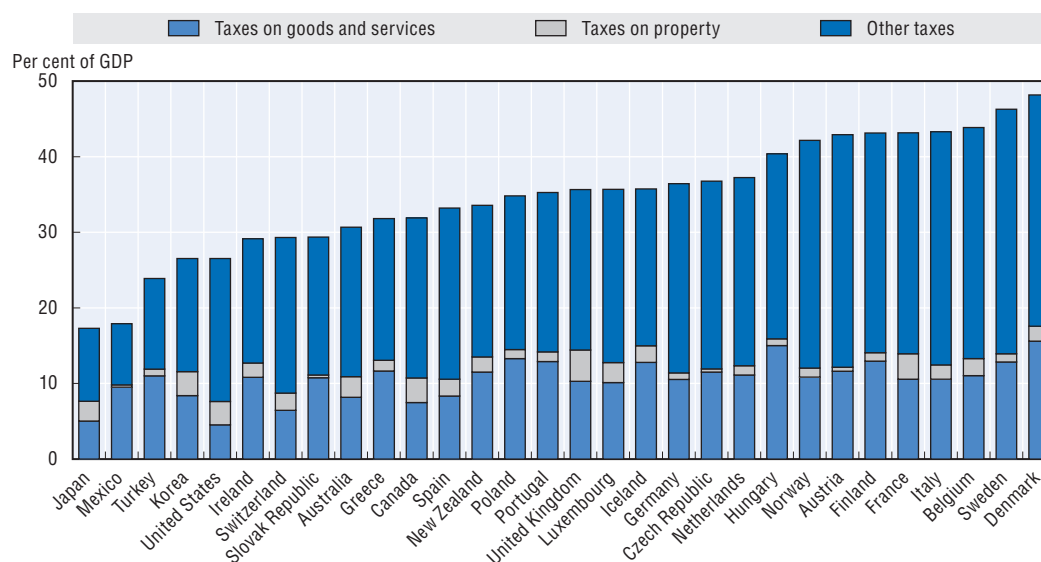
While difficult to quantify, tax expenditures have probably increased over time, notably in order to address market failures or income redistribution concerns, and may now be very large, possibly reaching close to 20% of total tax revenues in Italy and the United States and 30% in the United Kingdom (OECD, 2009c). When an alternative cost-efficient way to reach the same objective exists, removing them is recommended as they need to be offset by other taxes and thereby generally increase distortions in the tax system (OECD, 2010h). Tax expenditures also make tax compliance more difficult. Improving the effectiveness of tax administrations in tax collection and the fight against tax evasion is another way to both enhance tax efficiency and reduce fiscal deficits, and the amounts of tax revenues involved can be significant.

Structural reforms that could improve fiscal positions indirectly

Product market reforms are mostly fiscally-neutral in the short term and are likely to contribute to a reduction of fiscal deficits in the medium term by increasing productivity – as well as employment – and therefore tax revenues. This productivity effect could be particularly important for lower-income OECD members and the BRIICS, where the stringency of regulations in product markets and thus the scope for productivity gains are particularly high, but fiscal deficits are low in most of them.²⁸ Product market reforms are recommended in the vast majority of countries.²⁹

Even if revenue neutral, tax reforms can also make some indirect contribution to fiscal consolidation through their medium term effects on income, productivity and tax receipts. For most OECD countries, recent empirical evidence points to significant impacts on productivity and investment from changes in tax structure involving lower personal and corporate income taxes offset by higher consumption and property taxes, as well as from tax-base broadening accompanied by lower marginal tax rates (see Arnold and Schweltnus, 2008; Johansson *et. al.*, 2008; OECD, 2010h). Among the sixteen countries with a recommendation in this area, there is more room for changes in countries where these indirect taxes are not predominant such as in Austria, Belgium, France, Germany, Italy, Japan, Norway, Sweden and the United States (Figure 1.8). In several countries, broadening tax bases would further enhance the efficiency of the tax system by enabling a reduction in tax rates and by cutting economic distortions and administrative compliance costs associated to tax expenditures. This has been identified as a key priority in Austria, Belgium, Greece, Italy, Korea, Portugal and the United States.

Higher flexibility in wage bargaining, a reduction in minimum labour costs or job protection reform to address labour market dualism could help to enhance the job opportunities of specific underemployed groups of the labour force such as young people and the low-skilled. Insofar as overall employment increases, such reforms would

Figure 1.8. Tax revenue as a share of GDP, 2008¹

1. 2007 for Australia, Belgium, Mexico, the Netherlands and Poland.

Source: OECD (2010), Tax Revenue Database.

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indirectly contribute to fiscal consolidation, as higher employment implies more taxes and less spending over the medium run. Labour tax wedge cuts offset by increases in other taxes could have the same effect. The need for such labour market reforms has been diagnosed as a priority in 19 countries,³⁰ while tax reforms involving labour tax cuts have been recommended in 16 countries.³¹

Table 1.4 sums up the potential co-benefits for fiscal positions from addressing the revised *Going for Growth* priorities. It reports the number of reform priorities that would directly and quickly improve the fiscal balance, and also provides for most OECD countries the potential cost savings that could be reaped by moving national education and health care systems to best practice. It turns out that many of the revised *Going for Growth* priorities could, if addressed, make a significant contribution to fiscal consolidation in most OECD countries. Education and health reforms would further strengthen those fiscal gains.

Effects of structural reforms on current account imbalances

The structural reforms recommended in *Going for Growth* may have important side effects on global current account imbalances which remain large (Figure 1.9) despite some shrinking during the crisis. Addressing these imbalances can enhance global financial stability, and as such it has been one of the main focuses of the G20 framework for strong, sustainable and balanced growth launched by G20 leaders at the Pittsburgh Summit in 2009. Even if it is not their main objective, structural policies may affect current account positions through their effect on the saving and investment decisions of households, firms and governments.

Current account imbalances and fiscal consolidation

Fiscal consolidation programmes implemented in most OECD countries – the magnitude of which tends to be larger on average in external deficit countries, possibly aided by the type of structural reforms discussed in the previous section, may contribute to

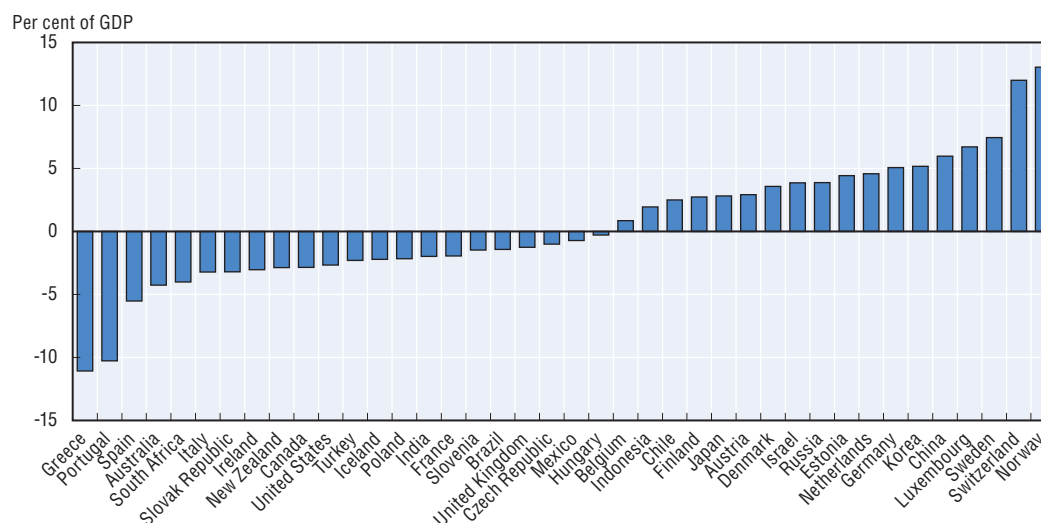
Table 1.4. **Potential impact of structural policies on fiscal positions**

| Countries | Net number of priorities with positive fiscal-side effects | Potential cost savings from increasing efficiency in the health care system (% of GDP) | Potential cost savings from increasing efficiency in the education system (% of GDP) |
|-----------------|--|--|--|
| Australia | 0 | 0.5 | 0.6 |
| Austria | +++ | 1.8 | 0.5 |
| Belgium | +++ | 2.1 | n.a. |
| Canada | 0 | 2.5 | n.a. |
| Czech Republic | ++ | 1.3 | 0.3 |
| Denmark | ++++ | 2.8 | 0.8 |
| Finland | ++++ | 2.5 | 0.3 |
| France | ++ | 1.3 | 0.3 |
| Germany | ++ | 1.3 | 0.6 |
| Greece | ++ | 3.9 | 0.6 |
| Hungary | +++ | 1.7 | 0.4 |
| Iceland | ++++ | 1.9 | n.a. |
| Ireland | 0 | 4.8 | 0.3 |
| Italy | ++ | 1.1 | 0.6 |
| Japan | ++ | 0.8 | 0.2 |
| Korea | 0 | 0.6 | 0.3 |
| Luxembourg | +++ | 2.0 | 0.8 |
| Mexico | + | 0.7 | 0.4 |
| Netherlands | ++ | 2.7 | 0.4 |
| New Zealand | ++ | 2.6 | n.a. |
| Norway | ++++ | 1.5 | 1.3 |
| Poland | ++ | 1.5 | 0.3 |
| Portugal | ++ | 1.0 | 0.2 |
| Slovak Republic | ++ | 2.7 | 0.4 |
| Spain | ++ | 1.6 | 0.3 |
| Sweden | +++ | 2.7 | 0.7 |
| Switzerland | +++ | 0.5 | 0.4 |
| Turkey | ++ | 1.5 | 0.2 |
| United Kingdom | +++ | 3.7 | 0.7 |
| United States | +++ | 2.7 | 1.0 |
| Brazil | 0 | n.a. | n.a. |
| Chile | - | n.a. | n.a. |
| China | + | n.a. | n.a. |
| Estonia | 0 | n.a. | n.a. |
| India | 0 | n.a. | n.a. |
| Indonesia | 0 | n.a. | n.a. |
| Israel | 0 | n.a. | n.a. |
| Russia | + | n.a. | n.a. |
| Slovenia | ++++ | n.a. | n.a. |
| South Africa | 0 | n.a. | n.a. |

Note: The first column reflects the sum of priorities that are likely to directly improve the fiscal position minus the number of priorities that are expected to weaken it. For example, (+++) indicates that three priorities (net of deficit-augmenting priorities) are likely to improve the fiscal balance.

narrowing the gap for deficit economies by increasing their overall saving rates. More generally, beside their impacts on the fiscal deficit, growth-friendly structural reforms may be considered in light of their direct effects on saving and investment behaviour. Results from new OECD empirical analysis (see Chapter 5 in this edition) help identify the side effects of structural policies on current accounts (Table 1.5):

- Many structural reforms affect current account imbalances by boosting productivity growth, which empirically is associated with a negative impact on the current account

Figure 1.9. **Current account balance, 2009**

Source: OECD (2010), OECD Economic Outlook No. 88: Statistics and Projections Database.

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position, at least over a short to medium-term horizon.³² This works notably through a higher investment rate, possibly reflecting the higher rate of return associated with productivity gains, which appears to more than offset possible positive effects on aggregate saving. This negative impact of productivity growth increases on current accounts tentatively suggests that many productivity-enhancing reform priorities identified in this edition of *Going for Growth* could contribute to reduce external imbalances in surplus countries.

- The empirical analysis in Chapter 5 suggests that, over and above its indirect effect through higher productivity growth, removing anti-competitive regulations in product markets could directly boost private investment, and thereby further reduce the current account position of surplus countries.³³ For instance, aligning the level of product market regulation in Japan and Germany – where reform is identified as a priority in this area – with OECD best practice could raise private investment in these countries by 0.6 and 0.7 percentage points of GDP in the short term, respectively.

In (most) emerging economies, introducing and/or scaling up social welfare systems would help citizens cope with various eventualities and therefore, as a side effect, help reduce excess precautionary saving and thereby weaken current accounts:

- According to recent OECD estimates, financed increases in social spending on health by 1 percentage point of GDP in OECD countries could on average reduce private saving by about 1.5% of GDP. The effect may be even higher for countries with low initial levels of social spending, possibly reaching 2½ per cent of GDP for China for instance, although there is wide uncertainty around this estimate. In the case of China, insofar as sustained increases in social spending remained unfinanced, they would prevent the expiry of recent fiscal stimulus from leading to a rise in public saving and the current account could weaken further.
- Reforms that aim to improve the sustainability of public pension schemes in industrialised economies by delaying the standard retirement age may help to reduce life-cycle saving in surplus countries: OECD estimates suggest that an increase in the

Table 1.5. **Overview of the estimated impact of some structural policies on saving, investment and the current account**

| | Total saving | Total investment | Implied effect on current account | Countries where the external imbalance could be reduced by addressing the corresponding priority |
|--|--------------|------------------|-----------------------------------|--|
| Increase in productivity growth | + | + | – | All current account surplus countries |
| Product market reform | | | | Belgium, China, Chile, Estonia, Germany, Denmark, Israel, Indonesia, Japan, Korea, Luxembourg, Norway, Russia, Switzerland |
| Improvement in coverage/quality of social welfare system | – | | – | Switzerland, Russia |
| Increase in statutory retirement age | – | | – | Finland, Belgium |
| Lowering of employment protection for regular workers | 0 | – | + | the Czech Republic, France, India, Italy, Portugal, Spain, Slovenia, Turkey |
| Financial market reform | 0/– | 0/+ | 0/– | |

Note: Based on the OECD estimates featured in the special chapter (Chapter 5) on this topic. The reported results refer to the medium- to long-run effect in all cases but PMR reform, where the short-run effect is shown. The identification of surplus and deficit countries is based on 2009 data.

statutory retirement age by one year could reduce total and private saving by around ½ percentage point of GDP in the medium to long run.

- Reforms of employment protection legislation do not appear to have any clear-cut side effects on saving behaviour, but relaxing job protection seems to strengthen current accounts through a decline in investment, possibly because firms substitute labour for capital as labour markets become more flexible. EPL reform might for instance contribute to reduce current account imbalances within the euro area, since it appears as a priority in France, Italy, Portugal, Slovenia and Spain.
- Financial market liberalisation, especially in emerging countries where it often implies curbing financial repression, should help to relax borrowing constraints for households and firms. Indeed, some estimates reported in the special chapter (Chapter 5) suggest that such reforms could reduce saving especially in less advanced economies. Investment may also rise, further weakening the current account.

Overall, these findings, together with the effects of structural reforms on fiscal balances discussed above suggest that a good number of the revised *Going for Growth* priorities could, if addressed, not only enhance living standards but also contribute to more balanced fiscal and/or current account positions (Annex 1.A2).³⁴

Notes

1. See Annex 1.A1 for the methodology used to select policy priorities and Annex 1.A2 for the list of recommendations for each country. As described in previous editions of *Going for Growth*, three priorities are selected using internationally comparable indicators of policy and performance, while two priorities are selected using indicators when available as well as country-specific expertise. Note that while the reforms discussed in this volume are systematically limited to five per country, in many cases, structural reforms in other areas are also needed.
2. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.
3. The BRIICS grouping includes Russia, which is in the process of accession to the OECD, and the five countries that have enhanced engagement with the OECD: Brazil, China, India, Indonesia and South Africa.

4. Broader measures of well-being are under development as part of the OECD's Global Project on Measuring the Progress of Societies, in part following up on the findings of the Stiglitz-Sen-Fitoussi Commission. While many alternative well-being measures are highly correlated with GDP per capita (see OECD, 2006a), broader measures may be important complements to evaluate issues such as, for example, income distribution, poverty, or environmental sustainability.
5. In last year's edition of *Going for Growth*, a broader measure of GDP that incorporates terms of trade effects was explored. This year, incorporating household production into GDP measurement is examined (Annex 1.A3).
6. Because financial reform requirements are general among countries and need to include some degree of international co-ordination, they are not systematically considered among country priorities but treated in Box 1.1.
7. The decomposition is based on 2009 data. Since then, all countries – and Greece and Iceland even more than others – have been adversely affected by macroeconomic shocks.
8. Annex 1.A2 summarises the five priorities for each country.
9. This was the case for instance with the tax 2001 reform in the Netherlands (Brys, 2010). The Swedish 1991 reform was also the object of a major evaluation exercise (Agell et al., 1996).
10. Because on balance most of the housing recommendations refer to the productivity channel, they are presented in the current section.
11. In Finland the efficiency of municipalities could also be improved through mergers and budget consolidation.
12. The OECD's Innovation Strategy has highlighted the importance of a broad range of education, regulatory, infrastructure and other policies that can help strengthen innovation systems, potentially enhancing durably productivity growth (OECD, 2010g).
13. Cross-country differences in the response of average hours worked reflect a number of features including collective bargaining and policy settings. Stricter job protection, more flexible hours averaging rules and in some cases collective bargaining agreements tend to encourage working-hours adjustment. Many countries, especially in Europe, have also encouraged employment retention by introducing or scaling-up often generous short-time working schemes (see OECD, 2010b, Chapter 5).
14. More specifically, reforms aiming to reduce social security contributions appear as a priority in Brazil, Germany, Hungary and Turkey.
15. An alternative scenario has been simulated where the extent of consolidation needed just to stabilise the debt-to-GDP ratios at current levels is assessed. The extent of total fiscal consolidation needs is much lower in this case: 5¼ per cent GDP for the OECD as a whole against 11½ per cent of GDP when the debt-to-GDP ratio is required to reach 60%. However, a scenario under which debt-to-GDP ratios are stabilised at current levels rather than reduced would still leave some countries with very high debt levels, of over 100% of GDP over the 2025 horizon (OECD, 2010c).
16. Countries with current debt below 60% are classified as having low consolidation needs according to the stylised scenario used here, but they should still pursue prudent fiscal policies with a view to maintaining longer-term sustainability.
17. This scenario does not include the effects on public budgets of population aging and continued upward pressures on health spending. In the typical OECD country, preventing or offsetting these spending pressures requires cumulative measures amounting to ¼ per cent of GDP per year over the coming 15 years just to keep the underlying primary deficit unchanged, although it might be slightly less on average for the larger OECD countries (OECD, 2010c).
18. OECD (2010c); IMF (2010a).
19. If benefits are not adjusted to productivity gains, this would imply a fall in the replacement rate.
20. The classification of reforms according to whether they primarily raise employment or productivity is stylised and reflects the main channel through which they are expected to increase GDP per capita. In practice, however, a number of reforms (e.g. a relaxation of anti-competitive regulations in product markets, a reduction in job protection of regular contracts) can have both employment and productivity effects.
21. Only China, Czech Republic, Germany, Iceland, India, Indonesia, Italy, Japan, Mexico, New Zealand, Slovak Republic, Spain, Russia and the United States do not have country-specific priorities in this area.

22. The indicators used in this section have not been used for the purpose of setting countries' priorities because there are currently no plans to update them on a regular basis, which would be necessary for their regular use in the *Going for Growth* process.
23. Improving efficiency in the public sector could increase productivity not only in the public sector but also in the private sector, for instance to the extent that the latter consumes services produced by the former.
24. Nine of forty countries, i.e. Belgium, Canada, Estonia, Ireland, Japan, Korea, Luxembourg, the Netherlands and Russia, do not have priorities in this area.
25. Given the uncertainty surrounding the potential efficiency gains from reforms of education systems, these estimates should however be taken with caution. There is similar uncertainty around the estimates of the fiscal gains from reforms of health systems discussed below.
26. The efficiency gains shown in Figure 1.6 are not strictly comparable across countries as they depend on the projected gains in life expectancy, which are country-specific as they are assumed to reflect a continuation of past trends. For more details, see Chapter 6 on the efficiency of health care systems across the OECD.
27. It should be noted that the total level of subsidies is likely to be higher than reported in national accounts because these do not record tax expenditures and cover a narrow scope (by excluding for instance capital investment grants). See OECD (2010c).
28. There is however tentative evidence that the marginal productivity gains from product market reforms are larger for industries/countries that are closer to the technological frontier, implying that a given decrease in the level of product market regulation may have a lower impact in lower-income countries (Bourles *et al.*, 2010).
29. They are actually recommended in all but five of the 40 countries covered: Finland, the Netherlands, Sweden, the United Kingdom and the United States.
30. Belgium, Chile, Czech Republic, France, Germany, Greece, India, Indonesia, Italy, Japan, Korea, Luxembourg, the Netherlands, Portugal, Slovenia, South Africa, Spain, Sweden and Turkey.
31. Austria, Australia, Belgium, Brazil, Denmark, Finland, France, Germany, Greece, Hungary, Italy, the Netherlands, Norway, Poland, Sweden and the United States.
32. This finding is at odds with some previous research which points out that an economy characterised by a relatively low growth rate tends to be characterised by a low income elasticity for its exports and high income elasticity for its imports, implying that demand and productivity effects might cancel out and leave current account positions and real exchange rates unchanged (Krugman, 1989).
33. Current account adjustment to productivity shocks also depends on whether these occur in the tradable or non-tradable sectors, with a larger deterioration to be expected in the former case (Dornbusch, 1983).
34. Regarding external imbalances, this analysis is largely consistent with results from the first stage of the G20 Mutual Assessment Process that were put forward by the IMF with OECD input presented at the June G20 meeting in Toronto (IMF, 2010b).

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ANNEX 1.A1

How Policy Priorities are Chosen for Going for Growth

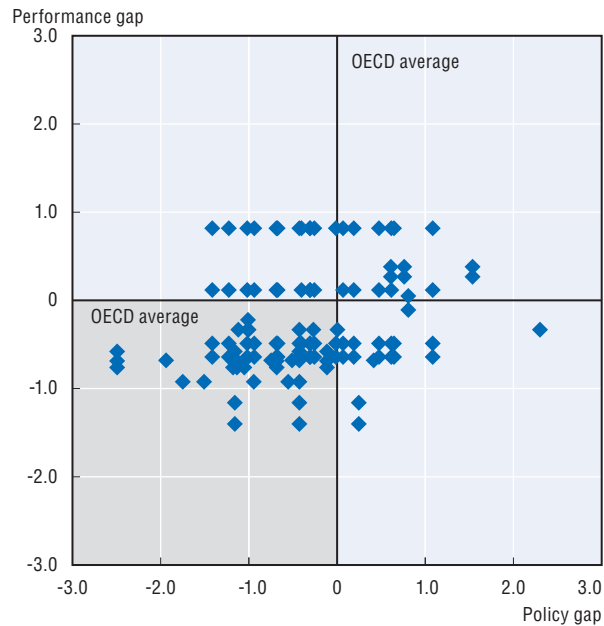
The *Going for Growth* structural surveillance exercise seeks to identify five policy priorities for each OECD member country, the BRICS and the EU. Three of these policy priorities are identified based on internationally comparable OECD indicators of policy settings and performance. The additional two priorities are often supported by indicator-based evidence, but may draw principally on country-specific expertise. These priorities are meant to capture any potential policy imperatives in fields not covered by indicators.

For the selection of the three indicator-based policy priorities, the starting point is a detailed examination of labour utilisation and productivity performance so as to uncover specific areas of relative strength and weakness. Each performance indicator is juxtaposed with corresponding policy indicators, where OECD empirical research has shown a robust link to performance, to determine where performance and policy weaknesses appear to be linked. This evaluation process is carried out for each of the approximately 50 areas where OECD policy indicators provide coverage.

As an example, Figure 1.A1.1 below shows, for a sample country, a scatter plot of pairings of policy indicators (on the horizontal axis) with corresponding performance indicators (on the vertical axis). Since many of the approximately 50 indicators are associated with more than one performance area, there are potentially more than 100 potential pairings to be examined. The indicators of policy and performance are standardised by re-scaling them so that each has a mean of zero and a cross-country standard deviation of one, with positive numbers representing positions more growth-friendly than the OECD average. The scatter plot is thus divided into four quadrants, depending on whether a country's policy-performance pairing is below or above the average policy or performance score.

Candidates for recommendations thus fall into the lower left quadrant, where policy indicators and corresponding performance are *both* below average. In most countries there are more than three unique policy areas that qualify as potential priorities (for instance, Germany had 16 candidates in the 2009 exercise). When there are more than three candidate policy priorities, the list has been narrowed using a combination of country expertise with the following criteria: i) the estimated quantitative impact of reforms in the policy area on GDP per capita as determined in previous OECD analysis, ii) the normalised distance of the policy stance from the benchmark (the OECD average), and iii) recent trends in policy and performance. The limit on the number of priorities means that for some countries, obvious policy imperatives may not be identified as priorities because other priorities are deemed as more important.

Figure 1.A1.1. **Example of selection of candidates for Going for Growth priorities**



StatLink  <http://dx.doi.org/10.1787/888932372982>

The empirical research linking policy with performance includes a long series of studies carried out by the Secretariat as well as the academic literature. OECD studies include for instance the OECD (2003), OECD (1994) and its reappraisal (OECD, 2006). Carrying out empirical analysis to strengthen the underpinnings of *Going for Growth* recommendations is an ongoing process. Some new empirical evidence on the policy and institutional drivers of long-term economic growth for both OECD countries and the BRIICS is featured in Bouis et. al. (2011).

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ANNEX 1.A2

Structural Policy Priorities¹

By country, performance area and impact on the current account (CA) and the fiscal position (FP)²

| | Labour utilisation | | Productivity | |
|------------------|--|-----------------|---|--------------------|
| Australia | <i>Improve incentives for workforce participation by reducing marginal effective tax rates, especially for low income families.</i> | | Enhance capacity and regulation in infrastructure by encouraging the use of cost-benefit analysis for public projects and by stimulating efficient investment decisions through the introduction of congestion charges and efficient market pricing. Relax barriers to FDI and increase transparency of approval decision to boost investment. Improve the efficiency of the tax system by reducing corporate and personal income tax to further rely on indirect taxes. <i>Enhance access to early education, especially for disadvantaged groups, to improve their educational outcomes.</i> | |
| Austria | Reduce disincentives to work at older ages by reducing the fiscal subsidisation of early retirement and tightening eligibility criteria for disability pension. <i>Strengthen incentives to work and entrepreneurship by reducing marginal taxes on labour income financed by broadening the tax base and more relying on indirect taxes.</i> | FP/CA CA | Raise graduation rates from tertiary education by extending the performance-based funding and allowing universities to set tuition fees backed by student income contingent repayment loans (ICRL). Promote competition in network industries by reducing ownership restrictions and other barriers to entry. <i>Promote competition in professional services by reducing statutory regulation of trades and professions and abolishing compulsory chamber membership.</i> | FP/CA FP/CA |
| Belgium | Reduce disincentives to work at older ages by phasing out remaining early retirement options. Further reduce tax wedges on low-income workers to increase employment opportunities for this group and move to a more efficient tax structure by further relying on indirect taxes. <i>Reform the wage bargaining system by decentralizing wage negotiations and phasing out wage indexation so that wages better reflect local labour market conditions.</i> <i>Reduce unemployment benefits with duration to strengthen work incentives.</i> | FP/CA CA | Promote competition in retail distribution by further easing regulation on zoning and opening hours as well as in network sectors by establishing a single independent regulator. | CA |
| Brazil | <i>Follow through the reform package of the tax system by notably reducing burden on labour income and unify the tax system.</i> <i>Improve incentive for formal labour force participation by encouraging human capital accumulation and lowering social contribution for low-paid workers.</i> | | Increase the quality of services at primary and secondary levels and expand tertiary vocational and professional training. Enhance economy efficiency by gradually lowering bank reserve requirement and phasing out distortionary mandated credit provisions to some sectors. Improve infrastructure provision by lowering regulatory uncertainty and removing legal barriers to competition to spur private investment. | |

| | Labour utilisation | | Productivity | |
|-----------------------|---|----|--|----------------|
| Canada | <i>Reform the employment insurance system by introducing a firm-level employer experience rating.</i> | | Reduce barriers to competition in network industries, retail and professional services. Continue to implement scheduled corporate tax rates reductions. Reduce high personal income taxes and move the tax base toward indirect taxes. Further reduce barriers to foreign ownership to boost productivity-enhancing capital deepening, especially in telecommunication and air transport sectors. <i>Improve incentive for innovation by reforming current R&D support programmes and re-focusing toward those with largest return.</i> | |
| Chile | Ease employment protection legislation for regular workers and increase unemployment benefits as a counterpart. <i>Strengthen female labour participation by extending publicly-financed early childhood education.</i> | | Ease product market regulation by reducing administrative burdens for start-ups, reduce barriers for entry in retail sector and simplify the bankruptcy law. Improve secondary and tertiary education outcomes to increase efficiency and the adoption of new technologies. Strengthen competition by implementing a new competition law. | CA CA CA |
| China | | | Reduce the importance of the state-owned sector in the economy to boost efficiency. Improve educational outcomes by reducing inequalities in the provision of education regionally and within urban areas. <i>Conduct a regulatory impact analysis to review all regulation and thereby reducing administrative burdens on companies.</i> <i>Further enhance intellectual property rights and the rule of law.</i> <i>Reduce barriers to urbanisation, so as to enable reallocation of labour to high-productivity sectors of the economy.</i> | CA CA CA |
| Czech Republic | Cut the costs of employment protection legislation (EPL) for regular workers to stimulate hiring. <i>Increase incentive to work for low income and second earners by reforming the tax-benefit system.</i> | CA | End the too-early selection process in secondary education and enhance the education outcomes. Implement proposals for tertiary education fees backed by student ICRL. Improve the business environment by further streamlining administrative procedures for start-ups and strengthen competition in electricity and telecommunication sectors. <i>Improve efficiency in public expenditures by reforming health care and public procurement mechanisms.</i> | FP FP |
| Denmark | Reduce the top marginal tax rates on labour income to cut disincentives to work longer hours while restraining public expenditure growth. Reduce subsidies to the disabled employment programme (<i>Fleksjob</i>) to encourage return to employment by those with some work capacity. <i>Reduce housing subsidies and abolish rent regulation to minimise housing market distortion and facilitate labour mobility.</i> | CA | Improving the efficiency of the education system by enhancing the culture of evaluation and introduce tuition fees backed by students ICRL. <i>Enhance competition in retail trade and continue with privatisation and outsourcing of publicly-funded services.</i> | CA CA |
| Estonia | Improve the capacity of the unemployment fund to provide efficient job assistance. | | Reduce barriers to entry in network industries especially in the electricity market. Reduce administrative burdens on businesses especially regarding the purchases of land by non-EU citizens. Further reduce barriers to FDI. Improve private bankruptcy proceedings. | CA CA |
| European Union | <i>Raise labour mobility by improving the portability of pension and social welfare benefits to improve intra-EU labour mobility.</i> | | Increase competition in services sector by ensuring effective implementation of the Services Directive. Raise competition in network industries by removing intra-EU barriers. Reduce producer support to agriculture by further decoupling payments to production. <i>Reforms financial regulation by giving sufficiently power to the newly-created European bodies and deepen market integration notably in retails.</i> | |

| | Labour utilisation | | Productivity | |
|----------------|---|--|--|-------|
| Finland | Strengthen work incentives by further reducing the tax wedge on labour income and shift the tax structure toward indirect taxes. | CA | Increase productivity in municipalities by relying more on outsourcing, promoting municipal mergers and increasing reliance on benchmarking. | FP |
| | Phase out early retirement pathways and increase the minimum statutory retirement age to reduce work disincentives at older ages. | FP/CA | <i>Improve efficiency of the tertiary education system by reducing inefficiencies in access to upper education and introduce tuition fees backed by student ICRL.</i> | FP/CA |
| | Strictly enforce job search requirements and reduce unemployment replacement rates to increase work incentives. | FP | | |
| France | Further reduce disincentives to work at older ages to raise employment of those above the age of 55. | FP | <i>Improve the quality and efficiency of tertiary education through further efforts to extend the autonomy of universities and higher tuition fees backed by student ICRL.</i> | FP |
| | Stimulate labour demand for youth and the low-skilled by further allowing the minimum cost of labour to decline relative to the average wage. Reduce the duality of the labour market by further reducing the protection of permanent jobs. | CA | <i>Reduce regulatory barriers to competition in network industries and retail distribution.</i> | |
| Germany | Strengthen work incentives by reducing social security contribution rates financed by efficiency gains in health care system and/or shift in the tax system toward indirect taxes. | CA | Reduce barriers to competition in services sector by simplifying the licence and permit system, the entry condition and easing conduct regulation. | CA |
| | <i>Reduce disincentives to full-time female labour force participation by moving to individual taxation of couples and introducing health care contribution for non working spouses.</i> <i>Ease employment protection legislation on regular jobs to avoid the development of a dual labour market.</i> | FP | Improve tertiary education outcomes by postponing early tracking, allowing universities to select student and introducing tuition fees backed by student ICRL. | CA |
| Greece | Continue to increase incentives to work at older ages by proceeding to the full implementation of the pension bill. | FP | Promote competition in network industries by reducing public ownership and proceed to the liberalisation of closed professions. | |
| | Continue efforts to broaden the tax base and tax evasion. Consider reducing the tax wedge on labour income over time to discourage evasion and informal activities. <i>Stimulate labour demand for youth by proceeding with the full implementation of law introducing a sub-minimum wage for young people.</i> | | <i>Raise the quality of education through improvements in teaching quality and increase in autonomy of schools.</i> | FP |
| Hungary | Further reduce social contributions in a revenue-neutral way so as to maintain a sound fiscal position. Finance recent tax cuts through expenditure restraint, base broadening and higher property taxes rather than through one-off distortive taxes on specific sectors and dismantling of the mandatory funded pension pillar. | | Ease business regulations by simplifying entry and exit procedures to encourage competition. | |
| | Encourage the labour force participation of older workers by further reducing implicit tax rates on continued work and phasing out access to early retirement programmes, including by tightening eligibility for disability benefits. | FP | <i>Improve the efficiency of education system by delaying early tracking, improving teacher training and introducing tuition fees backed by student ICRL.</i> | FP |
| Iceland | | | <i>Promote public sector efficiency by ensuring cost-efficiency of services.</i> | FP |
| | | | Improve education outcomes by strengthening school accountability and improving teacher quality. | FP |
| | | | Reduce producer support to agriculture. | FP |
| | | | Reduce foreign ownership restrictions in the fisheries and electricity sectors to increase competition. | FP |
| | | <i>Introduce performance-based budgeting in the public sector to raise public-sector efficiency.</i> | FP | |
| | | <i>Reduce legal barriers to entry in electricity, telecommunications and transport sectors.</i> | | |

| | Labour utilisation | | Productivity | |
|------------------|--|----|---|----------------------------|
| India | Improve labour market flexibility in the formal sector and reduce protection measures that discriminate against large firms. | CA | Reduce trade and FDI barriers notably in retail and other service sectors as well as administrative burdens. Improve education outcomes by decentralising school management and recruitment, increasing teacher training and autonomy in universities. <i>Reduce regulatory uncertainty to enhance infrastructure provision from private sector.</i> <i>Develop the financial sector to meet the needs of a rapidly developing economy.</i> | |
| Indonesia | Simplify dismissal procedures and reduce severance payments while introducing some form of unemployment benefits to address informality. | | Improve the efficiency of secondary education by making income transfer conditional on attending school and financing fee for disadvantaged children. Improve the environment for infrastructure by reducing regulatory barriers and uncertainties to spur private investment. <i>Ease barriers to entrepreneurship and continue to fight corruption by reforming the tax office and simplifying business licensing.</i> <i>Phase out energy subsidies.</i> | CA CA CA |
| Ireland | Strengthen work incentives for women by further targeting and, as fiscal circumstances allow, increasing the supply of childcare. <i>Enhance activation policies by tightening conditionality and reducing the number of agencies involved in providing assistance to the unemployed.</i> | | Strengthen competition in retail, electricity and gas markets. Remove unnecessary restrictions in the legal profession. Enhance R&D spending and innovation by ensuring that government support channels through efficient tools and promoting the links between universities and the private sector. <i>Further improve the quality and quantity of infrastructure provision. Allow for better use of infrastructure services through appropriate user charges.</i> | FP |
| Israel | Reduce tax wedge and corporate tax. Shift tax structure toward indirect taxes. Encourage labour supply among low-income households by re-introducing a placement scheme, increasing the coverage of earned-income-tax credit, reducing the value of minimum wage relative to average. | CA | Improve education outcomes by reforming upper-secondary school. Cut red tape for businesses to boost firm entry and productivity. Complete network industry reform notably in electricity and telecoms sectors. | CA CA CA |
| Italy | <i>Relax job protection on permanent contracts to increase labour demand for permanent workers and reduce labour market dualism.</i> | CA | Reduce regulatory and administrative barriers to competition notably in professional services. Improve efficiency of secondary and tertiary education by promoting evaluation, improving the quality of teachers and setting tuition fees backed by student ICRL. Reduce the tax wedge on labour income and the corporate tax rate and shift the tax structure toward indirect taxes. <i>Reduce public ownerships in some sectors. Enhance competition especially in media TV.</i> | FP FP |
| Japan | Reduce the duality of the labour market by cutting the costs of EPL for regular workers while expanding insurance coverage for non-regular. | | Increase competition in network industries, particularly electricity, notably by further deregulation and privatisation. Further scale back the level of support to agriculture, while shifting its composition away from support based on output and towards direct support for farmers. <i>Remove restrictions on FDI especially in services.</i> <i>Reform the tax system to rely more on indirect taxes to reduce the efficiency cost of taxation.</i> | FP/CA FP/CA CA CA |

| | Labour utilisation | Productivity | |
|--------------------|---|---|----|
| Korea | Reduce employment protection for regular workers to reduce the incentives to hire non-regular workers and improve training opportunities. | Further reduce entry barriers in network industries and services and relax FDI restrictions to stimulate productivity. | CA |
| | <i>Strengthen female labour force participation by expanding the availability and the quality of child care by relaxing price control.</i> | Reduce producer support to agriculture. | CA |
| | | <i>Improve the efficiency of the tax system by broadening tax bases and shifting toward indirect taxes.</i> | CA |
| Luxembourg | Improve work incentives by reducing replacement rates of social benefits, tightening unemployment insurance eligibility and activating labour market policies. | Increase competition by liberalizing professional services and retail sectors opening hours. | CA |
| | Reduce disincentives to work at older ages by phasing out early retirement schemes. | | CA |
| | <i>Reform employment protection by easing conditions on collective dismissals and reducing restrictions on temporary contracts.</i> | | |
| | <i>Improve the functioning of the housing market by reforming the planning system and reducing implicit tax subsidies to home ownership.</i> | | |
| Mexico | | Raise achievement in primary and secondary education to raise productivity and the adoption of new technologies. Promote competition in network industries by reducing regulatory barriers to entry. Reduce barriers to foreign ownership especially in electricity and telephony sectors. <i>Improve the "rule of law" to strengthen competition and investment.</i> <i>Improve the governance of the state-owned oil company and facilitate risk and profit sharing with other companies to enhance efficiency.</i> | |
| Netherlands | Lower marginal effective tax rates to strengthen incentives to full-time labour force participation for low income and second earners. | | |
| | Ease employment protection legislation for workers on regular contracts by making the current dual system of dismissal more predictable. | | |
| | Extend the new tighter entry controls and better monitoring to all existing disability benefit recipients to encourage work by those with substantial work capacity. | FP | |
| | <i>Temper unemployment benefit duration to enhance incentives to work.</i> | FP | |
| | <i>Make the housing market more flexible and cut transaction tax to strengthen labour mobility.</i> | FP | |
| New Zealand | | Reduce barriers to competition in network industries. Ease entry barriers for foreign acquisition of large firms and reduce regulatory opacity. | FP |
| | | Improve educational achievement, in particular among ethnic minorities, to raise efficiency of the labour force. <i>Boost direct public R&D funding, raise the effectiveness of R&D support by fostering policy co-ordination.</i> | FP |
| | | <i>Improve public-sector efficiency by implementing the welfare reform.</i> | FP |
| | | | |
| Norway | Reform disability benefit schemes to encourage work by partially disabled through reinforcement of conditionality. | Reduce legal barriers to entry in some services, notably telecommunications, retail and post. | CA |
| | <i>Reduce marginal income tax rates to strengthen incentives to full-time labour force participation and shift tax system toward indirect taxes and property taxes.</i> | Reduce producer support to agriculture. | CA |
| | | <i>Raise the efficiency of secondary education by reducing the number of schools, improving teacher training and relying on performance indicators.</i> | CA |

| | Labour utilisation | | Productivity | |
|------------------------|--|----|---|----|
| Poland | Reform the tax and benefit systems by further reducing the tax wedge and tightening eligibility for early retirement. | | Reduce public ownerships by further privatisation. | FP |
| | | | Improve the provision of pre-school education and introduce fees in tertiary education backed by students ICRL. <i>Increase transport, communication and energy infrastructure.</i> <i>Increase housing supply by reforming zoning arrangements.</i> | FP |
| Portugal | Ease employment protection legislation on regular contracts and refocus unemployment benefit systems. | CA | Improve secondary and tertiary attainment to raise efficiency of the labour force. | FP |
| | | | Foster competition in retail and railways, make licensing less restrictive in professional services and downscale public ownership in transportation. <i>Reduce administrative burdens on business at the local level.</i> <i>Simplify the tax system and broaden the tax base notably by reducing tax expenditures for all taxes.</i> | FP |
| Russia | | | Lower barriers to trade and foreign direct investment by reducing tariffs level and dispersion and by shortening the list of strategic sectors. | CA |
| | | | Reduce state control over economic activity by reducing the list of strategic firms and by favouring regulatory measures to direct interventions. | CA |
| | | | Raise the effectiveness of innovation policy by pursuing reforms in the state science sector and by relying more public support on fiscal incentives. <i>Raise the quality of public administration by simplifying regulation, reducing bureaucratic interference in private sector and corruption.</i> | |
| | | | <i>Increase public funding and efficiency of health care system by improving incentives for providers and developing prevention policies.</i> | CA |
| Slovak Republic | Raise female labour force participation by shortening the duration of parental leave entitlements in favour of childcare subsidies. <i>Reduce long-term unemployment by strengthening policies to promote labour mobility notably through the expansion of training measures.</i> | | Improve the effectiveness of the education system and the funding through the introduction of tuition fees backed by student ICRL. | FP |
| | | | Foster competition by reducing administrative burdens on firms and resuming privatisation process in telecommunication and energy sectors. <i>Improve the innovation framework by reducing administrative burden on start-ups and facilitating access to venture capital.</i> | FP |
| Slovenia | Relax employment protection legislation by further easing individual dismissals. | CA | Reform product market regulation by reducing state ownership in network industry and corporate governance of firms in which the State holds stake. | |
| | Reduce the disincentives to work at older ages by rising the statutory retirement age. <i>Abolish the indexation of public sector wages and ensure the minimum wage is indexed to inflation for a while.</i> | | <i>Improve tertiary educational outcomes by linking student benefits to performances and introducing tuition fees backed by student ICRL.</i> | |
| South Africa | <i>Strengthen policies to tackle youth unemployment by implementing an age-differentiation of minimum wages, wage subsidies and intensifying placement assistance.</i> Weaken administrative extension of collective bargains and provide for indicative guidelines for wage bargains at centralized level. | | Raise the quality of education and reduce its dispersion by improving teacher training, schools infrastructures and phasing out schools fees. Enhance competition in network industries by removing entry barriers and phasing out granting state-owned enterprises. <i>Reduce barriers to entrepreneurships and reduce administrative burdens based on a review of existing legislation.</i> | |

| | Labour utilisation | | Productivity | |
|-----------------------|--|----------|--|----------|
| Spain | Make wage more responsive to economic and firm-specific conditions by abolishing legal extension of collective wage agreements. | | Improve secondary education by evaluating vocational schools and raising school autonomy. | FP |
| | Ease employment protection legislation for permanent workers by considering introducing a single contract. <i>Further lengthen the contribution periods required for a full pension and abolish subsidies to partial retirement to increase incentives for older workers to continue working.</i> | CA FP | <i>Strengthen competition in retail distribution by lowering regional barriers to large-surface outlets.</i> | |
| Sweden | Pursue reforms of sickness leave and disability benefit systems to increase labour force participation. | | <i>Improve the efficiency and quality of education by strengthening compulsory schooling and introducing tuition fees in universities.</i> | CA |
| | Relax EPL for regular contracts by easing procedures for dismissals. Reduce marginal tax rates on labour income to strengthen incentives to work longer hours by further raising income tax threshold and shift tax burden toward property and consumption taxes. <i>Reform housing policies to encourage labour mobility.</i> | CA | | |
| Switzerland | Strengthen incentives to full-time work for women by a nation-wide voucher scheme to subsidise childcare and an individual taxation of couples. | | Remove barriers to competition in network industries by strengthening the regulator's powers, removing legal barriers to access the telecommunication sector and privatising the postal services provider. | CA |
| | | | Reduce producer support to agriculture. <i>Improve tertiary education by delaying tracking and raising tuition fees backed by student ICRL.</i> <i>Contain health-system costs by abandoning the mixed hospital funding.</i> | CA CA |
| Turkey | Contain minimum wage increases to stimulate employment of low-skilled workers in the formal sector. Ease employment protection, liberalise temporary work and allow flexible forms of labour contracts to stimulate hiring in the formal sector. <i>Reduce disincentives to work in the formal labour market by making the pension system actuarially neutral.</i> | CA | Improve educational achievement and increase public education spending financed by broadening tax base. <i>Simplify product market regulations, pursue especially the simplification of licensing rules and advance privatisations.</i> | |
| United Kingdom | Further reform the disability benefit scheme by extending it to all existing claimants. | FP/CA | Improve the education achievement of young people by increasing quality of early-childhood education and increase secondary school participation. Improve public infrastructure, especially for transport, to reduce bottlenecks. | FP |
| | | | <i>Improve the efficiency of health and other publicly-funded services.</i> <i>Make the planning system more flexible to encourage supply of land for housing and commercial development.</i> | FP |
| United States | | | Improve primary and secondary education by improving teacher training and strengthening schools' accountability for student progress. | FP |
| | | | Improve the efficiency of the health care sector by pursuing efforts to reform Medicare. Improve the efficiency of the tax system by shifting toward consumption taxes. <i>Strengthen policies to promote social mobility by increasing participation in early childhood education, reducing financial barriers to participation in tertiary education.</i> <i>Reduce producer support to agriculture notably tariffs on imported ethanol, sugar and dairy price support.</i> | FP FP |

1. The priorities in italics are not necessarily based on indicators.
2. CA denotes priorities that could contribute to reduce the current account surplus or deficit. FP denotes priorities that could contribute to strengthen the fiscal position in countries identified in the main text as having moderate to very large fiscal consolidation needs.

ANNEX 1.A3

Incorporating Household Production Into International Comparisons of Material Well-Being

Traditional national income accounting has generally followed the principle that households are final consumers – rather than producers – of goods and services. Consequentially, goods and services produced by households for the market are included in economic aggregates such as GDP, as are goods produced for own-consumption, such as agricultural products and own-account construction, but non-market services produced by households, with the notable exception of dwelling services, are not. This has the problematic implication that when services are sourced from the market rather than produced at home, national income rises, even if the volume and/or quality of actual production and consumption does not increase. For international comparisons purposes, this could be especially problematic for comparisons of countries at earlier stages of development, where markets for certain types of food, cleaning and childcare services are less developed.

Satellite accounts have been constructed in a number of OECD countries to help to address this problem (including for Australia, Canada, Finland, Germany, Hungary, Mexico and the United Kingdom). A recent study of the United States, for example, showed that extending the production boundary to include household production of non-market services not already included in GDP would increase US GDP by 19% using the replacement cost approach (with production valued at housekeepers' hourly wages), and 62% using the opportunity cost (using average hourly wages) approach.¹ Interestingly however, average annual real growth over the period 1985-2004 differed by only 0.1% percentage point between the two approaches, indicating that non-market services (as a share of total output) do not vary significantly over time. In terms of income gaps, the Commission on the Measurement of Economic Performance and Social Progress set up by French President Sarkozy found that broadening measures of material well-being to incorporate household production would reduce the income gap between France and the United States by about 5 percentage points (Stiglitz-Sen-Fitoussi, 2009).

This annex explores measures that extend GDP measurement to non-market production using recently available time-use surveys, and thereby may come closer to true measures of material well-being. Overall, these measures present a picture of national income that is quite different from the traditional one, on average 45% higher than standard measures of GDP per capita. However, they are also surrounded by a considerable degree of uncertainty, with different choices of methodology leading to 25% or 66% higher average GDP per capita, depending on whether the replacement cost or opportunity cost

method is used. Nevertheless, the ranking of countries in terms of income is not substantially affected by the incorporation of household production, whichever price basis is used, although the income gap between the five lower income OECD countries in the sample and the sample average is reduced substantially (by about 20 percentage points). Yet the ranking can change more substantially for labour productivity levels once non-market production and the associated inputs (in terms of hours worked) are accounted for, with several countries changing their position in the distribution rather dramatically.

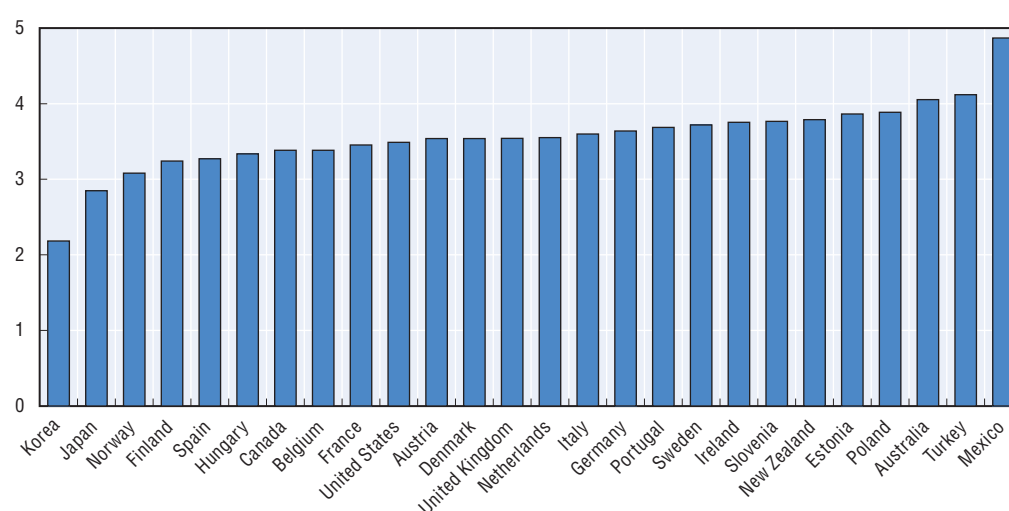
Making use of time-use surveys

The starting point for this work is a new database of time-use surveys collected by the OECD (Miranda, 2011). This database collates time-use surveys conducted by national statistics institutes for 2008 using a classification of activities based on five primary categories defined by the OECD: paid work or study (work-related activities); unpaid work (household activities); personal care; leisure;² other activities not included elsewhere.

For the purposes of measuring household production of non-market services, the relevant activity is unpaid work, which is broken down into the following two-digit groups: routine housework; shopping; care for household members; care for non household members; volunteer work; and travel related to household activities. Unfortunately not all countries are able to provide a breakdown into all six categories and, so, this analysis looks only at total time spent on overall unpaid work. Some of this time will be spent on activities related to the production of goods such as agricultural products for own-use, or the production of goods such as community housing, through voluntary work, that are not for own-use. The output related to the production of these goods is, at least in theory, already included within estimates of GDP. Therefore, estimates of household production of non-market services that include these activities will be biased upwards, though the size of such bias is expected to be small.

The figure below (Figure 1.A3.1) summarises the information available from time-use surveys for 26 OECD countries. It shows that in most OECD countries the average time per

Figure 1.A3.1. **Average hours spent on unpaid household work per person, 2008¹**



1. Includes people aged 15 and older. Austria and Denmark are set at the European Union average.

Source: OECD estimates based on national time use surveys.

StatLink  <http://dx.doi.org/10.1787/888932373001>

person spent on unpaid household work falls between three and four hours per day, with the notable exceptions of Korea, where the average is just over two hours per day, and Mexico, where the average is close to five hours per day.

When households produce own-account services, they use labour input (household members' time) and capital (consumer durables). Two approaches are used to estimate the value of the labour supplied in producing these services (see Box 1.A3.1 which also provides details on the approach used to estimate the value of capital services). The first is the *replacement cost* approach; where an average post-tax, hourly wage, representative of the broad range of activities covered in the production of household production of non-market services, is constructed using data collected in the OECD-Eurostat PPP programme. The second, to provide some measure of the potential range of estimates (in practice an upper bound), is the *opportunity cost*³ approach, which takes the average post-tax hourly wage across the whole economy (see OECD, 2010).

The effect on income levels is very large but cross-country rankings are little affected

Applying the methods discussed above to estimate household production yields estimates of material well-being that are significantly higher in level terms than standard GDP per capita measures. Figure 1.A3.2 shows the results of the two methods of estimating household production of non-market services. These estimates apply both the labour cost and the capital services estimates described in Box 1.A3.1. Using the replacement cost method, the augmentation of GDP per capita ranges from 10% for Norway to 50% for Mexico, averaging 25% across the OECD sample. With the opportunity cost method, the augmentation is even larger: 32% in the case of Norway and 121% for Mexico, and 66% on average.

While the effect on the level of income is drastic, the effect on the relative position of countries is much less substantial.⁴ The rankings stay qualitatively similar, though some countries certainly improve in their position – for instance, Germany and Portugal each jump forward in the distribution (Figure 1.A3.3). More substantively, the distribution is compressed, with the five lowest income countries' GDP per capita augmented by well more than average: with the replacement cost method, these countries' income rises by 38% compared with 25% on average; with the opportunity cost method, they increase by 93% *versus* 66%. Although the large margin of uncertainty that surrounds these estimates using the two methods suggests caution in using these augmented figures in practice, volume-based (real) international *comparisons* of incomes are much less affected by the choice of methods – as evident in the fairly stable ranking of countries across both methods.

In principle, cross-country comparisons of productivity levels could be more affected than comparisons of GDP per capita levels, at least through a composition effect – i.e. because the relative number of hours devoted to household production varies across countries, and the relative productivity of household production *vis-à-vis* other economic activities also varies across countries – and further OECD work will be carried out on this issue. However, whether any changes in cross-country rankings of productivity levels would have implications for *Going for Growth* reform priorities is less clear. For instance, insofar as most policies and institutions have only little direct impact on the productivity of non-market household services, the latter may be ignored when mapping productivity measures with structural policy indicators to identify priorities.

Box 1.A3.1. The opportunity cost versus replacement cost approaches

Conceptual arguments can be made that favour both the opportunity and replacement cost approach, although the latter seems generally more in line with national accounts concepts. In practice, most studies that have produced estimates of household production have based these estimates on replacement costs, following the underlying valuation principle that the ultimate goal is to obtain the equivalent market value of the non-market services produced. In other words, it is the price that would be paid for somebody else to produce the same quality of service. Another advantage of the replacement cost approach over the opportunity cost approach is that the latter necessarily assumes that any person considered, including those outside the labour force such as full-time housewives or retirees would be able to find a job in the market according to his or her qualifications, which is a very strong assumption. One could even go as far as setting the opportunity cost equal to zero (see Abraham and Mackie, 2007) in the extreme case where the individual's competences have no value on the labour market. However, estimates based on the opportunity cost approach are not meaningful. At the very least they provide in practice an upper bound on estimates of household production. Therefore they are also shown in this analysis.

A complication arising in the replacement cost approach is that the underlying general principle for the valuation of hourly labour costs should in theory be the quality-adjusted price of a specialist worker in the activity being measured, where the quality is adjusted to reflect the lower productivity of non-specialised individuals. In practice and in this annex however, many studies do not adjust for quality, and those that do generally rely on fairly arbitrary estimates of the productivity gap between specialists and non-specialists. Landefeld *et. al.* (2009), for example, assumed that the average hourly wage was 75% of the specialist hourly wage in a number of activities. Because this study focuses on total time spent on unpaid work, and because price information is not readily available for the six specific two-digit categories of unpaid work in time-use surveys, estimates cannot be based on the costs of specialised labour in specific activities. Instead, this study relies on an overall hourly labour cost estimate based on prices of market activities that are representative of the main activities conducted by households in the production of non-market services, such as the wages of unregistered domestic servants.

The estimates of hourly wages for both the replacement and opportunity cost approach are based on the assumption that the market price would reflect the prices paid for informal, unregistered labour, and so are net-of taxes and social security contributions. Not all studies have estimated labour costs on this basis, and some have for example used gross measures. For the replacement cost approach, when direct estimates of the hourly wages of unregistered workers are not available, estimates of hourly post-tax wage costs are based on hourly wage costs of registered workers adjusted for taxes and social security contributions using data from *OECD Taxing Wages 2009*, where the tax "wedge" is computed as the average tax and social security contributions paid by employees (as a per cent of total wages) across two situations, namely for a single person with no children earning two-thirds of the national average annual salary and for a single person with two children earning two-thirds of the national average annual salary. Similarly, for the opportunity cost approach the average tax wedge is calculated as the average for a single person earning 100% of the national annual average salary and a sole earner married with two children earning 100% of the national annual average salary. It is important to note in this context that estimates of "net" prices based on registered workers may be biased downwards in comparison to unregistered workers since the after-tax cost of labour charged by unregistered workers may be higher in order to reflect at least some of the social benefits captured by registered workers. Similarly the choice illustrative family situations considered in the calculation of the tax wedge for the replacement cost approach reflect the fact that unregistered workers are typically at the lower end of the salary scale.

Box 1.A3.1. The opportunity cost versus replacement cost approaches (cont.)

The overall approach to measure the (replacement or opportunity) costs of labour used in the production of household non-market services for own use can be simply described as follows:

$$\begin{aligned} & \text{Value of labour used in household production of non-market services in nominal currency} \\ & = \\ & \text{Average hourly post-tax labour costs} \\ & * \\ & \text{Average hours worked per day} \\ & * \\ & \text{Days in a year} \\ & * \\ & \text{Population, 16 years-of-age and over} \end{aligned}$$

For the purpose of cross-country comparisons, the preference and focus of this annex is to present results in volume terms – in other words by converting the nominal values into 2008 US dollars using purchasing power parities, and comparing country estimates on the basis of both the replacement and opportunity costs.

Beyond labour inputs, capital services are another basic input in the production of household non-market services, and may also substitute for labour. Clearly innovations and inventions such as the dishwasher, washing machine, and microwave have provided possibilities for substituting capital for labour. Including the contribution of consumer durables is important therefore to fully reflect the consumption of goods and services by households in a consistent way across countries and over time. Consumer durables used in this analysis are based on the Eurostat-OECD (2007) classification of final expenditure by GDP category, which includes household appliances, motor vehicles and also categories of consumer durables, such as furniture, that provide capital services related to dwelling services – but dwelling services themselves are not included in this study. It is important to note that these estimates will be biased upwards since some consumer durables, such as cars, also provide capital services to commuting and leisure activities.

The results shown in this annex are based on measures of the productive stock of consumer durables constructed using the perpetual inventory method, based on the standard stock-flow relationship:

$$K^t = K^{t-1}(1-\delta) + I^t$$

Where, K^t is the end-of-the-period net stock of consumer durables, I^t is the flow of purchases of consumer durables during period t in constant (chained) prices, δ is the geometric rate of depreciation, set at 20%. Note that no distinction is made between different types of consumer durables in this analysis.

The value of capital services is measured as the price of capital services per unit of the net stock multiplied by the net stock (see Jorgenson and Griliches, 1967). The capital service price contains three elements: return on capital, depreciation, and revaluation of capital goods. A simplified version of the capital service price for consumer durables is estimated as:

$$P_K^t = P_I^t [r+\delta]$$

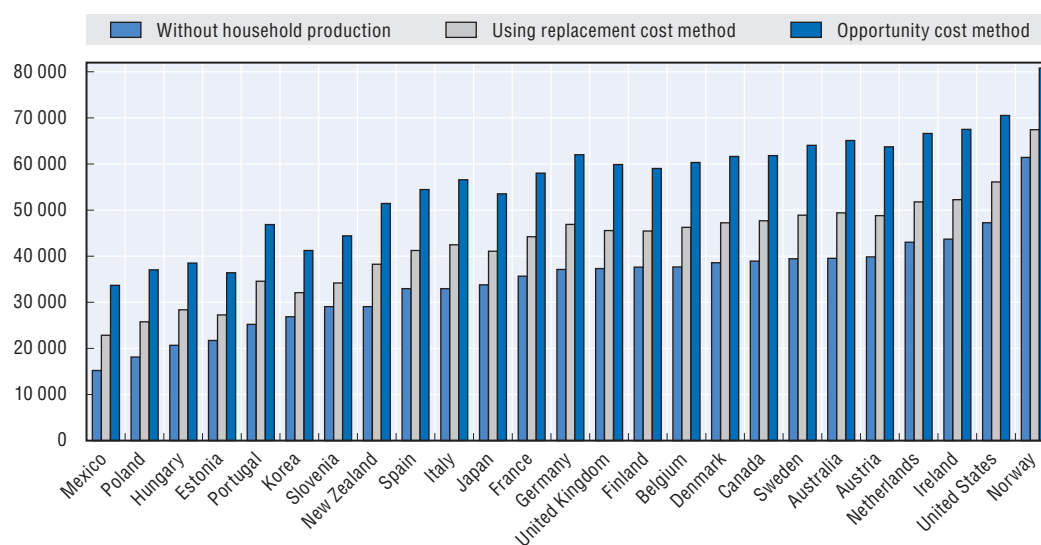
Where r is the real rate of return, set at 4% per year, P_K^t is the price of capital services and P_I^t is the price index of consumer durables. The value of capital services from consumer durables is therefore:

$$P_K^t K^t = [r+\delta]P_I^t K^t$$

Source: Abraham, K. and C. Mackie, eds. (2005), *Beyond the Market: Designing Non-market Accounts for the United States*, The National Academy of Sciences; Landefeld, S., B. Fraumeni and C.M. Vojtech (2009), "Accounting for Nonmarket Production: A Prototype Satellite Account Using the American Time Use Survey", *Review of Income and Wealth*, Vol. 55, No. 2; OECD (2010), *Taxing Wages 2009*; OECD/Statistical Office of the European Communities, Luxembourg (2007), *Eurostat-OECD Methodological Manual on Purchasing Power Parities*; Jorgenson, D.W. and Z. Griliches (1967), "The Explanation of Productivity Change", *Review of Economic Studies*, Vol. 34, No. 3.

Figure 1.A3.2. **GDP per capita with and without household production, 2008**

Current USD PPP

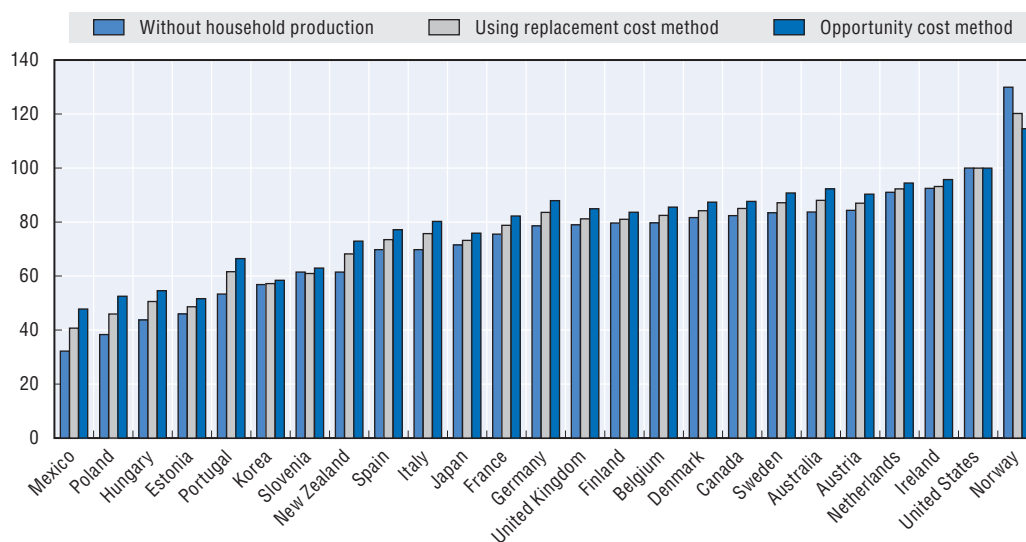


Source: Ahmad, N. and S-H Koh (2011), "Incorporating Household Production into International Comparisons of Material Well-Being", OECD Statistics Directorate Working Papers, forthcoming.

StatLink <http://dx.doi.org/10.1787/888932373020>

Figure 1.A3.3. **GDP per capita with and without household production, 2008**

USA = 100



Source: Ahmad, N. and S-H Koh (2011), "Incorporating Household Production into International Comparisons of Material Well-Being", OECD Statistics Directorate Working Papers, forthcoming.

StatLink <http://dx.doi.org/10.1787/888932373039>

Notes

1. See Landefeld, et al. (2009).
2. This annex focuses on time spent on household production. From a time-use perspective, value could also be given to other ways in which time is spent, in particular leisure. Placing a value on time spent on leisure, such that it can be compared with the benefits gained from conventional consumption of market goods and services or the consumption of goods and services produced by households for their own use, is considerably more challenging, both empirically and conceptually, and thus is not examined in this annex.
3. A full opportunity cost approach would calculate the opportunity costs for each individual separately rather than for an average individual.
4. It should be stressed that any potential cross-country differences in the productivity of households in producing household goods are not taken into account in these calculations, however.

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