

PART I
Chapter 2

Responding to the Going for Growth Policy Priorities: an Overview of Progress since 2005

Against the background of a stronger need for reform in the wake of the crisis, this chapter assesses the progress that each country has made over the past five years in a broad range of structural policy areas where government action could boost long-term growth. Two-thirds of OECD countries have sought to address at least one of the five policy weaknesses that were identified over the period. However, such reforms have been mostly incremental rather than radical in nature, and have seldom fully addressed the underlying policy deficiencies. Reforms have also been more frequent where they were expected to deliver immediate benefits – such as for increased spending on active labour market policies or tax cuts – than where they might have hurt the short-term interests of specific groups – such as with incumbent investors, farmers and permanent workers under competition policy, agricultural policy and job protection reforms.

Introduction

Since its inception in 2005, *Going for Growth* has identified structural policy priorities for each OECD country and the European Union to raise GDP per capita, an imperfect but still useful proxy for material living standards (see Box 2.1 for a broad overview of welfare measures). The priorities have aimed at improving long-term material living standards by reforming policies that impede efficiency and labour utilisation. Five policy priorities were first identified in 2005 for each country and the European Union, which were then reassessed in the 2007 and 2009 editions based on both observed progress in reform and new evidence. Policy priorities have been mainly concentrated on labour and product market policies, but have also covered education, health, innovation, housing policies, the efficiency of public sectors and tax systems, and, very occasionally, the financial sector.

This chapter provides a broad overview of the progress that countries have made on the identified policy priorities since 2005. Because reform is often a lengthy process, five years – rather than just one year as in the 2006 and 2008 editions of *Going for Growth* – is an appropriate time span to evaluate the extent to which countries acted on their priorities and to identify broad reform patterns. At the same time, this assessment is subject to a number of caveats, both conceptual and practical (Box 2.2). While looking at reforms carried out since 2005, the chapter also covers in detail actions taken over the past year, including early stages of reforms such as government statements, formal consultation and draft legislation presented to parliaments.

Progress in reform is assessed at a time when most OECD countries are gradually recovering from a deep recession.¹ This crisis has raised new structural policy challenges, such as reviving economies and consolidating public finances in a way that also fosters sustainable long-term growth, and avoids non-co-operative, anti-competitive regulatory and trade measures that could aggravate the effects of the crisis. These policy issues are analysed in the lead chapter of this year's edition of *Going for Growth*. At the same time, as argued in that same Chapter 1, the structural reform priorities set last year remain by and large valid, and many of them may have in fact become even more urgent in the current context. This is particularly true of measures in the areas of active labour market policies, product market regulation (PMR) or employment protection legislation (EPL) that would speed up the economic recovery. This is also true of reforms of early retirement schemes that would prevent the large recent declines in employment from triggering permanent withdrawals from the labour market. Accompanying country notes highlight the structural reform priorities that it would be most beneficial to address at the current juncture (Chapter 3).

The main reform patterns that emerge from the stocktaking exercise carried out over the period 2005-2009 are the following:

- OECD countries have indeed followed up on *Going for Growth* policy priorities since 2005. Two-thirds of them took some legislative action in at least one of their priority areas each

Box 2.1. A broad overview of welfare measures

A broad examination of measures of well-being was completed in September 2009 by the Commission on the Measurement of Economic Performance and Social Progress, which was set up by the French President and led by Joseph Stiglitz, Amartya Sen and Jean-Paul Fitoussi. The Commission considered a wide range of alternatives to GDP per capita, including national accounts-type measures, more general quality of life measures, as well as measures of environmental sustainability.

The numerous weaknesses of GDP per capita as a measure of well-being were highlighted in the report, many of which were previously discussed in a *Going for Growth* chapter on “Alternative Measures of Well-Being” (OECD, 2006). One objection is that as a measure of material well-being, GDP is less suited than other national accounts-based measures because it is a gross production concept, whereas an income concept that is net of international transfers and capital stock depreciation should be preferred. However, as discussed in OECD (2006), such measures correlate well across countries with GDP per capita in levels (used in this report), though they show somewhat larger differences in terms of growth rates. More significantly, and because of measurement issues, GDP also poorly captures the quality of health or government services, and makes no allowance for the depletion of natural resources and the degradation of the environment.

Cross-country comparisons of both income levels and growth rates based on GDP per capita can be significantly altered when household production and/or the value of leisure time are accounted for. Methods to take account of these differences have been developed, although they often require substantial imputations.¹ Accounting for household production and leisure time could increase by as much as half conventionally measured GDP in many countries. For instance, including such adjustments to income may nearly halve the gap in household incomes between France and the United States (Stiglitz *et al.*, 2009). However, such estimates are surrounded by a considerable degree of uncertainty – much more than for conventional GDP. Given the high degree of uncertainty in estimating alternative measures of well-being that are more wide-ranging than national accounts-based income measures, the Commission concluded that a broad array of indicators is needed to make robust assessments of well-being.

Income inequality is another factor that may lead cross-country comparisons based on average income levels to give a skewed impression of well-being (see OECD, 2006). This is because one currency unit of additional income is generally seen to be worth more to low-income households than to richer ones. This issue has gained prominence in recent years, as economy-wide (average) income gains have accrued disproportionately to high-income households, as illustrated in the table below (OECD, 2009).

Another set of issues relates to the measurement of dimensions of individual well-being which go beyond material aspects such as income. Measures of the quality of life, including subjective well-being, are appealing in this regard and they often do not correlate well with more conventional measures of income, wealth, or even human development, such as health and life expectancy (OECD, 2006). They may capture other, broader drivers of well-being such as social attachments or the quality of institutions, although answers to surveys could also reflect differences in *relative* well-being within communities. As a result, such indicators are likely to be most useful as complementary measures rather than as substitutes to more conventional measures of well-being.

Box 2.1. A broad overview of welfare measures (cont.)

Trends in real household incomes by quintiles

	Average annual change mid-1990s to mid-2000s				
	Bottom quintile	Middle three quintiles	Top quintile	Median	Mean
Australia	2.4	2.0	1.9	2.2	2.0
Austria ¹	-2.1	-0.5	-0.4	-0.6	-0.6
Belgium ¹	1.4	1.3	1.7	1.2	1.5
Canada	0.2	1.2	2.1	1.1	1.4
Czech Republic ¹	0.4	0.6	0.7	0.5	0.6
Denmark	0.6	0.9	1.5	0.9	1.1
Finland	1.6	2.5	4.6	2.5	2.9
France	0.9	0.7	1.0	0.8	0.8
Germany	-0.3	0.5	1.3	0.6	0.7
Greece	3.6	3.0	2.7	2.9	2.9
Hungary	0.9	1.2	1.0	1.1	1.1
Ireland ¹	5.2	7.7	5.4	8.2	6.6
Italy	2.2	1.0	1.6	1.0	1.3
Japan	-1.4	-1.0	-1.3	-1.0	-1.1
Luxembourg	1.5	1.5	1.7	1.5	1.6
Mexico	-0.1	-0.1	-0.6	-0.2	-0.4
Netherlands	1.8	2.0	1.4	2.0	1.8
New Zealand	1.1	2.2	1.6	2.3	1.9
Norway	4.4	3.9	5.1	3.8	4.3
Portugal ¹	5.0	4.1	4.4	4.2	4.3
Spain ¹	5.2	5.1	5.0	5.5	5.1
Sweden	1.4	2.2	2.8	2.2	2.3
Turkey	-1.1	-0.5	-3.2	-0.3	-1.9
United Kingdom	2.4	2.1	1.5	2.1	1.9
United States ²	-0.2	0.5	1.1	0.4	0.7
OECD ³	1.5	1.8	1.8	1.8	1.7

- Changes over the period mid-1990s to around 2000 for Austria, Belgium, the Czech Republic, Ireland, Portugal and Spain (where 2005 data, based on EU-SILC, are not deemed to be comparable with those for earlier years).
- A large discrepancy exists between current population survey and national accounts-based measures of household income for the United States. A large part of the discrepancy is explained by exclusion from household measures of income increases in fringe benefits such as employers' contributions to social security, pensions and health insurance (see Burtless, 2007).
- Refers to the simple average for all countries with data.

Source: *Growing Unequal? Income Distribution and Poverty in OECD Countries* (OECD, 2009).

This report continues to use GDP per capita as its primary aggregate measure of performance (with a revised numéraire for comparison²), given its timeliness and ready availability. It is also important to note that *Going for Growth* uses detailed indicators of productivity and labour utilisation in order to identify performance weaknesses. Such indicators are clearly not measures of well-being and as such are less subject to some of the critiques that have been made for GDP. In the current edition, one narrow but still highly relevant performance measure in the context of globalisation, namely real gross domestic income (GDI) per capita – a measure that takes into account income gains and losses through international trade, which in several OECD countries have been large enough to induce a significant gap between the growth rates of GDP and broader income measures in recent years – is evaluated in Annex 2.A2.

- Supplementary “satellite” accounts provide a framework for incorporating into national accounts measurements activities outside of the conventional GDP production boundary such as the environment and household activities.
- The numéraire for aggregate income comparisons has been revised from the United States to be the simple average of the upper half of OECD countries in each year, which makes comparisons less sensitive to US-specific factors.

Box 2.2. **Conceptual and practical issues involved in assessing progress on *Going for Growth* priorities**

Assessing progress on reform priorities involves a number of conceptual and practical issues, especially when – as in this chapter – quantitative indicators of reform activity are constructed (see also Annex 2.A1):

- *Going for Growth* identifies five reform priorities for each OECD country. The assessment of progress implicitly treats all of them as equally important and assumes their effects to be linear and independent from one another. In practice, however, pay-offs differ across fields and may depend on the magnitude of the measures implemented and how they are combined.
- Three out of the five policy priorities are based on internationally comparable policy indicators which have been linked empirically by the OECD to various aspects of economic performance. The other two policy priorities are mostly based on a judgement of the most binding constraints on material living standards. Although there is a wealth of empirical analysis linking these other policies to economic performance, it is conceptually challenging to assess the strength of overall reform activity.
- Even when available, not all OECD structural policy indicators are available on a timely basis, and some of them necessarily capture reforms with lags, for example when implementation is spread over several years and/or follows a decision with long lags (e.g. pension reforms).¹ For this reason, and also in order to allow for equal treatment of indicator-based and non-indicator-based priorities, this chapter relies primarily on more qualitative information to assess the significance of reforms (the matching between this qualitative information and OECD policy indicators is discussed in Box 2.3).
- Determining whether a priority has been sufficiently addressed is not straightforward. In principle, if deemed sufficiently radical, action taken is followed by the removal of the corresponding priority in the subsequent *Going for Growth*. Yet, *Going for Growth* is an evolving process, and changes in priorities may reflect not only measures taken but also a reassessment of priorities on the basis of new information and empirical analyses, as well as the emergence of even more urgent priorities.
- Finally, responsiveness to priorities should not necessarily be construed as reform activity more broadly. This is because reforms in non-priority areas are only loosely covered in the *Going for Growth* process, though they matter for economic performance – especially for countries where, in fact, a large number of areas qualified as potential priorities but, at most, five of them could ultimately be retained (see *Going for Growth* 2009).

1. By contrast, some OECD structural policy indicators are forward-looking in the sense that they do not capture the current but rather the eventual stance of policy, once already enacted legislation is fully implemented. In particular, OECD estimates of implicit taxes on continued work measure steady-state financial incentives to retire once all already legislated pension reforms are phased in.

year. Likewise, about a quarter of the countries subject to a priority in a given reform field acted every year.

- OECD countries have been more responsive to *Going for Growth* recommendations when looking over longer time spans. For example, while only one-third of 2005 priorities had been followed with significant action by 2006, that share increased to two-thirds by 2008, although it appears to have levelled-off since then.

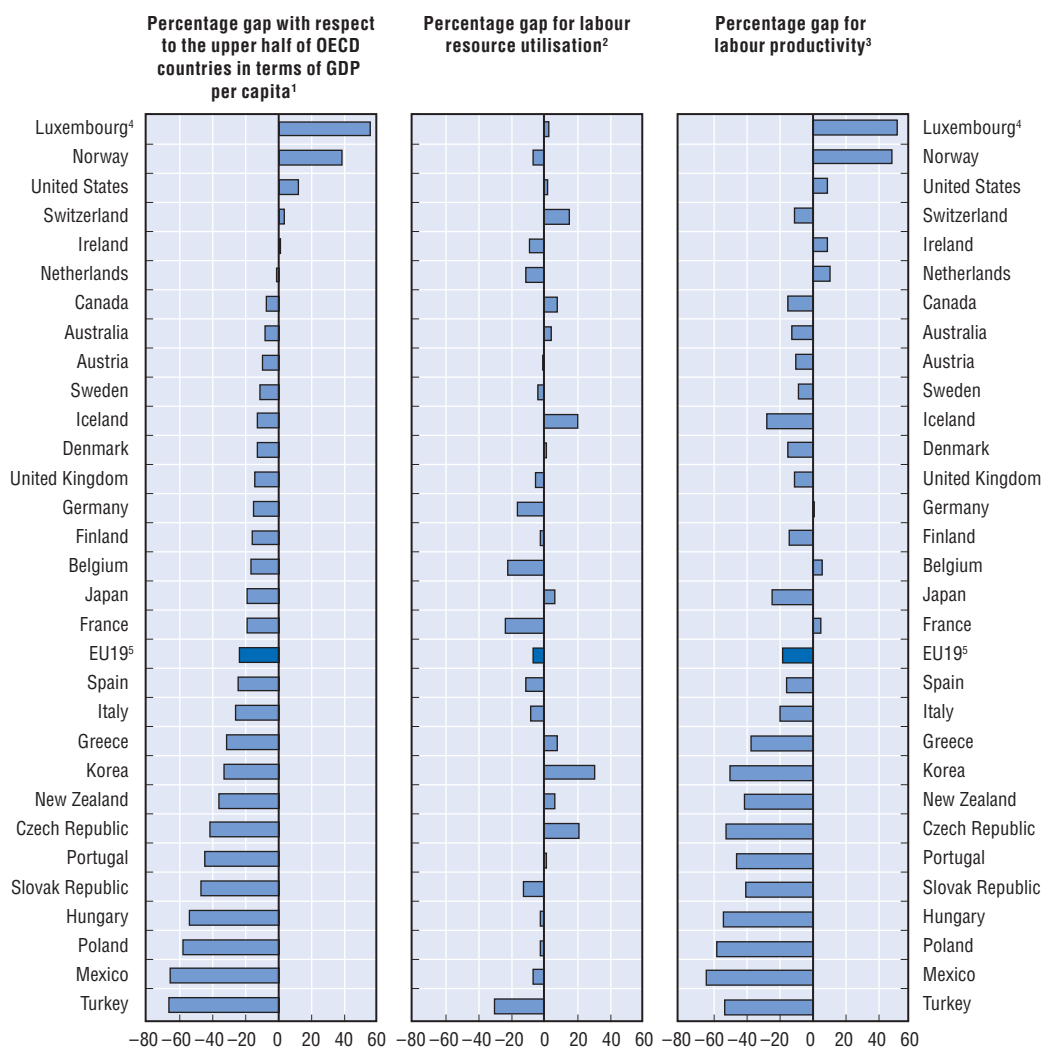
- Dramatic reforms are politically difficult to implement. Hence, actual reforms have typically been incremental in nature. The bulk of the measures taken have not yet been deemed ambitious enough, in terms of scale and scope, to warrant a removal of the corresponding *Going for Growth* priority.
- OECD countries have made more progress in labour productivity-enhancing reform areas than in those targeted at labour utilisation. Policy responses to priorities aimed at boosting productivity levels have been strongest in the areas of innovation policy and public sector efficiency, and weakest for agricultural support policies. Actions taken to raise labour utilisation have been most widespread in the fields of labour taxation – including in 2009 as part of the fiscal stimulus packages implemented by many OECD countries – as well as in active labour market policies and retirement, disability and sickness support schemes. By contrast, little progress has been achieved on priorities dealing with employment protection legislation, wage formation, unemployment benefits, housing policies and health care systems, although some strides have been made in these areas in a number of countries not subject to priorities.
- Reforms appear to be politically easier to undertake where they entail only benefits and little or no short term cost (e.g. labour tax cuts, increased spending on active labour market or innovation policies), and harder to carry out where they may hurt the short-term interests of specific groups (e.g. farmers under agricultural policy, permanent workers under job protection reforms, incumbent investors when it comes to competition reform).
- Countries that have been most active at reforming since 2005 are quite dispersed in terms of geography, size and income levels, although a majority are small OECD economies. There is only a weak link between the apparent need for reform and subsequent reform activity. Those countries that had lower GDP per capita levels and/or poorer growth performance before 2005 have not necessarily been more responsive to *Going for Growth* priorities, while those with higher incomes and/or better performance were not necessarily less responsive.

Progress in reforming policies to improve labour productivity performance

Since the 2005 issue of *Going for Growth*, policy priorities aimed at improving productivity performance have been mainly concentrated on countries with a large gap in output per hour worked *vis-à-vis* the most productive OECD economies (Figure 2.1) and/or weak productivity growth over the past decade (Figure 2.2).² Such countries have included some North American and Asia-Pacific member countries, as well as a few of the smaller European countries and the European Union as a whole. Suggested policy reforms to boost productivity have included the easing of entry restrictions and controls over business operations in specific product markets, measures to improve educational outcomes, cuts in distortionary agricultural support to improve resource allocation throughout economies, and various other measures. The countries concerned have achieved only mixed progress since 2005 in the areas of education and agriculture, but have generally followed up to a greater extent on recommendations in other areas, including product market regulation.


Product market regulation

The easing of unduly restrictive regulations in product markets has been identified as a priority for most OECD countries – especially those with sub-par productivity performance – and would help them recover faster from the crisis. The European Union

Figure 2.1. **The sources of real income differences, 2008**

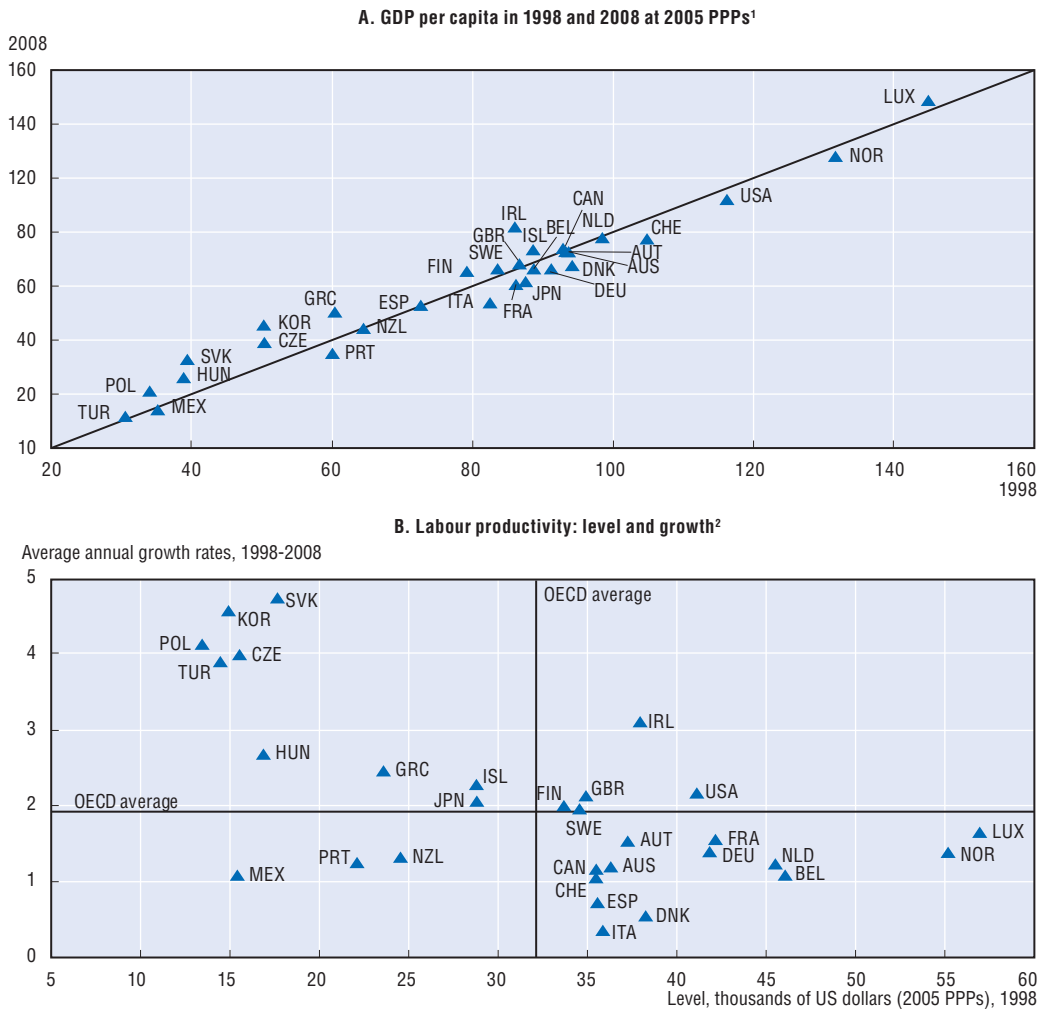
1. Relative to the simple average of the highest 15 OECD countries in terms of GDP per capita, based on 2008 purchasing power parities (PPPs). The sum of the percentage gap in labour resource utilisation and labour productivity do not add up exactly to the GDP per capita gap since the decomposition is multiplicative.
2. Labour resource utilisation is measured as total number of hours worked per capita.
3. Labour productivity is measured as GDP per hour worked.
4. 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.
5. The EU19 is an aggregate covering countries that are members of both the European Union and the OECD. These are the EU15 countries plus the Czech Republic, Hungary, Poland and the Slovak Republic.

Source: OECD, National Accounts Database; OECD, Economic Outlook 86 Database and OECD (2009), OECD Employment Outlook.

StatLink  <http://dx.doi.org/10.1787/786610417714>

has taken some steps to foster cross-border competition among its member countries since 2005. The Services Directive, albeit somewhat limited in scope and short of the original proposal, goes in this direction. It was passed in Spring 2006 and was fully transposed into national law at the end of 2009. The Single European Payments Area (SEPA), launched in January 2008, moved forward in November 2009 with the implementation of a new scheme for cross-border direct debits, and will gradually reduce the costs of financial transactions across borders.

Figure 2.2. **GDP per capita and per hour worked: Level and change**



1. In constant 2005 PPPs, relative to the simple average of GDP per capita for the upper half of OECD countries in terms of GDP per capita in 1998 and 2008, which is normalised to 100. 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.
2. Measured as GDP per hour worked in constant prices at 2005 PPPs.

Source: OECD, National Accounts Database and OECD (2009), OECD Employment Outlook.

StatLink <http://dx.doi.org/10.1787/786610417714>

At the individual country level, around two-thirds of the countries concerned have followed up on recommendations to ease product market regulations since 2005, and the actions taken have been sufficient to result in a removal of the corresponding priorities in around half of these cases (Tables 2.1 and 2.2):

- Easing entry restrictions in services and network industries has been identified as a policy priority for a large majority of OECD countries. In network industries, most have taken action by separating ownership of network elements (Hungary, the Netherlands and Portugal), making third-party access and public tendering mandatory (Poland in the telecommunications sector and Portugal), easing entry restrictions and/or consolidating the power of the regulatory authority (Austria, Canada in 2009, Germany, Greece, Italy, Korea, Mexico and Switzerland), introducing incentive-based regulation (Germany), relaxing threshold restrictions on the free choice of suppliers (Japan), creating a national

Table 2.1. **Progress made in countries with recommendations to reduce entry and operational controls**¹

	2005-2008				2009					
	Action taken	Action taken implying removal of the priority	No significant measure	Policy relapse	Reviews/laws announced	Public consultation	Legislation concluded	Other measures	No significant measure	Policy relapse
Reduce entry barriers in services and/or industries in general										
Austria	X								X	
France	X								X	
Iceland			X						X	
Ireland			X						X	
Italy	X								X	
Japan	X			X					X	
Korea	X								X	
Norway			X	X					X	
Poland	X								X	
Slovak Republic			n.a.						X	
Turkey			X						X	
Reduce entry barriers in network industries										
Australia	X								X	
Canada			X				X			
Germany	X								X	
Greece	X						X			
Hungary	X								X	
Ireland	X								X	
Luxembourg			X						X	
Mexico	X								X	
Netherlands		X						n.a.		
New Zealand	X				X					
Portugal	X								X	
Switzerland	X								X	
Reduce entry barriers in professional services										
Austria	X								X	
Canada	X						X			
Germany	X								X	
Hungary			n.a.						X	
Luxembourg			X						X	
Switzerland		X						n.a.		
Reduce entry barriers in retail distribution										
Austria									X	
Belgium	X								X	
Denmark	X								X	
France	X								X	
Hungary			n.a.						X	
Ireland		X						n.a.		
Netherlands			X						X	
Spain			X		X					

n.a.: Denotes that the corresponding priority was not yet introduced over the period considered, or was dropped following commensurate actions taken.

1. The table covers only countries with policy recommendations in the area listed. The first set of columns titled "2005-2008" give a synopsis of the progress on 2005 *Going for Growth* priorities in 2005 and 2006 and on 2007 priorities in 2007 and 2008. Similarly, the last set of columns titled "2009" relate to progress on 2009 *Going for Growth* priorities in 2009.

Table 2.2. **Progress made in countries with recommendations to reduce administrative costs, public ownership and reform corporate governance**¹

	2005-2008				2009					
	Action taken	Action taken implying removal of the priority	No significant measure	Policy relapse	Reviews/laws announced	Public consultation	Legislation concluded	Other measures	No significant measure	Policy relapse
Reduce administrative burdens										
Austria		X			-----		n.a.	-----		
Belgium		X			-----		n.a.	-----		
Czech Republic	X								X	
Denmark	X							X		
Greece		X			-----		n.a.	-----		
Hungary		X			-----		n.a.	-----		
Netherlands		X			-----		n.a.	-----		
Poland	-----	n.a.	-----				X			
Portugal	-----	n.a.	-----					X		
Turkey		X			-----		n.a.	-----		
Reform corporate governance										
Italy		X			-----		n.a.	-----		
United States			X						X	
Reduce the scope of public ownership										
Finland			X		X					
Denmark			X				X			
Greece			X				X			
Mexico	-----	n.a.	-----						X	
Norway			X						X	
Poland			X					X		
Sweden		X			-----		n.a.	-----		
Turkey		X			-----		n.a.	-----		

n.a.: Denotes that the corresponding priority was not yet introduced over the period considered, or was dropped following commensurate actions taken.

1. The table covers only countries with policy recommendations in the area listed. The first set of columns titled "2005-2008" give a synopsis of the progress on 2005 *Going for Growth* priorities in 2005 and 2006 and on 2007 priorities in 2007 and 2008. Similarly, the last set of columns titled "2009" relate to progress on 2009 *Going for Growth* priorities in 2009.

operator for both electricity and gas with transmission planning functions to further enhance the functioning of the national energy market (Australia). In retail trade, legislative measures have taken the form of reductions in entry barriers for large retailers (slight reform in Belgium, under preparation in Spain in 2009), relaxations in retail pricing regulation (France and Ireland), and extensions of shop opening hours (Austria, Belgium to some extent, Denmark, and Finland in 2009). New Zealand reduced uncertainties regarding the regulatory framework and launched reviews of the performance and governance of the electricity market and local telecommunications services obligations. Canada and Switzerland reduced barriers to internal trade, notably in professional services. Canada also signed an agreement to liberalise air travel with the European Union in 2009. Denmark took action across the board by introducing a leniency programme in competition law, and Austria eased restrictions on cross-holding of equity for businesses supplying related services. The actions taken by Ireland, the Netherlands and Switzerland were deemed ambitious enough to warrant the elimination of some of their priorities.

- Administrative burdens have been assessed as a policy weakness in ten countries. All countries but Portugal – for which the priority was set only in 2009 but where some measures had been taken earlier as part of the SIMPLEX programme – have taken some measures by streamlining registration and licensing procedures (Belgium, Greece, Hungary and Turkey), creating a one-stop shop for start-ups (the Czech Republic and Poland in 2009), simplifying bankruptcy procedures (Austria and the Czech Republic), and strengthening benchmarking in publicly-funded services and cutting business red tape (Denmark in 2009). Following significant policy action in most of the countries concerned, lowering administrative burdens remained one of the five policy priorities in the 2009 *Going for Growth* only for the Czech Republic, Denmark and Poland, although sustained efforts will continue to be required elsewhere for administrative burdens to remain constrained.
- Reducing the scope of public ownership has been recommended for eight countries. Sweden, Turkey and Poland (in 2009) have intensified privatisation efforts since 2005, while no significant progress has been recorded in Finland, Mexico and Norway. Sweden also took steps to ensure a level-playing field by enacting a new Public Procurement Act and making the National Board for Public Procurement part of the Competition Authority, while Denmark appointed a new Public Procurement Committee in 2009 to encourage public-sector competition. Most recently, the crisis put a brake on privatisation efforts across the OECD and forced increases in public ownership in the financial sector, though Greece privatised the public airline company Olympic Airways in 2009.

By contrast, there has been some policy relapse in a few countries. In Japan, the zoning regulations that were enacted in 2006 to revitalise suburban areas have erected potential entry barriers for (large) retail stores. In New Zealand, while recommendations focused on divesting public ownership and dismantling entry barriers in international air transport and rail, the rail network has been re-nationalised – which, however, does not need to undermine competition and efficiency if a level playing field is maintained among network users – and ownership restrictions have been tightened against a possible foreign take-over of Auckland Airport. In Norway, the government has simplified procedures to reverse Competition Authority decisions on grounds other than competition.

Human capital

In all but three OECD countries (Canada, Japan and Korea), raising human capital through reforms of primary, secondary and tertiary education systems has been advocated to lift productivity levels. Progress in reform at primary and secondary levels since 2005 has been mixed, with about half of the 14 countries concerned following up on recommendations, and only two of them (Australia and Belgium) in a way that justified removing the priority (Table 2.3). The specific measures implemented in this area have included curricula reforms (Iceland, Ireland, Mexico and Turkey), increased flexibility of vocational education and training and greater responsiveness to the needs of the labour market (Australia, Portugal and the United Kingdom), higher teacher qualification requirements (Mexico and Iceland) and teacher performance evaluations (Portugal), strengthened school and teacher accountability through wider use of standardised exams (Germany), financial incentives for teachers to work in disadvantaged schools (the United Kingdom in 2009), increased support for students from disadvantaged backgrounds (Belgium, Mexico, Portugal and the United Kingdom), and more compulsory years of schooling (Portugal in 2009).

Table 2.3. **Progress made in countries with recommendations to improve educational outcomes¹**

	2005-2008				2009					
	Action taken	Action taken implying removal of the priority	No significant measure	Policy relapse	Reviews/laws announced	Public consultation	Legislation concluded	Other measures	No significant measure	Policy relapse
Reform pre-primary education										
Australia	-----	n.a.	-----						X	
Denmark	X								X	
Germany			X						X	
Ireland			X				X			
Poland	-----	n.a.	-----						X	
United Kingdom	-----	n.a.	-----						X	
Reform primary and secondary education										
Australia		X			-----	n.a.	-----			
Belgium		X			-----	n.a.	-----			
Germany	X								X	
Iceland	X								X	
Ireland			X						X	
Luxembourg			X						X	
Mexico	X								X	
New Zealand			X						X	
Norway	-----	n.a.	-----				X			
Portugal	X						X			
Spain	-----	n.a.	-----						X	
Turkey	X								X	
United Kingdom	X						X			
United States			X						X	
Reform tertiary education										
Austria	X			X					X	
Czech Republic			X						X	
Denmark	X								X	
Finland	-----	n.a.	-----						X	
France	X								X	
Germany	X								X	
Greece	X					X				
Hungary	X								X	
Italy	X								X	
Portugal	X								X	
Poland			X						X	
Slovak Republic	X								X	
Spain		X			-----	n.a.	-----			
Sweden	X				X					
Switzerland	-----	n.a.	-----		X					

n.a.: Denotes that the corresponding priority was not yet introduced over the period considered, or was dropped following commensurate actions taken.

1. The table covers only countries with policy recommendations in the area listed. The first set of columns titled "2005-2008" give a synopsis of the progress on 2005 *Going for Growth* priorities in 2005 and 2006 and on 2007 priorities in 2007 and 2008. Similarly, the last set of columns titled "2009" relate to progress on 2009 *Going for Growth* priorities in 2009.

Reform of early childhood education has gained increasing attention in the *Going for Growth* exercise over the years, reflecting mounting evidence of high returns from investments in human capital earlier in children's lives. Many of the recommendations in this area have been set recently. As a result, countries have had little time so far to respond to these priorities, and progress in reform has been limited. Denmark has taken significant measures by introducing compulsory language screening for three-year-olds to detect language difficulties early and bolstering student evaluation. In 2009, Ireland has introduced the Early Childhood Care and Education scheme to extend pre-school education.

Reform of tertiary education systems has been flagged as a priority in many Continental European OECD countries. Most of them have taken some measures, although further action is still needed to address long-standing deficiencies. The reforms undertaken since 2005 have included:

- Strengthening the funding of universities through the introduction or extension of tuition fees (Germany, the Slovak Republic).
- Improving the governance of universities (Greece, which in 2009 also launched a public consultation on education reform), including through greater autonomy (France, Germany, Portugal and Spain) or by creating a new independent accreditation agency to support internal quality assessments of universities (Switzerland in 2009).
- Encouraging early completion by adjusting university funding (Denmark), or by facilitating direct transition from upper-secondary to tertiary education (Sweden).
- Developing professionally-oriented vocational training (Portugal) and introducing courses with vocational content where needed (Hungary).
- Promoting international partnerships and fostering greater international mobility of students and graduates (Portugal).

By contrast, low-level tuition fees have been abolished in Austria.

Agriculture

There has been a significant fall in producer support to agriculture across the OECD since 2005, albeit mainly due to a combination of fluctuating commodity prices and automatic mechanisms built into policy instruments rather than as a result of substantial reform progress (Table 2.4). Nevertheless, the composition of support has shifted towards less distortionary measures, reflecting limited but positive developments in agricultural support policies. In 2008 the European Union launched its Common Agricultural Policy (CAP) health check, laying down plans for further decoupling support by 2013. However, the re-introduction of European Union farm export subsidies in 2009, after two years of suspension of payments, was a step back. In the United States, while more market-oriented support for tobacco has been a step in the right direction, the Food, Conservation and Energy Act of 2008 maintains high agricultural subsidies through 2013 and provides additional scope for support tied to the production of certain commodities – notably for the sugar and dairy sectors. The new crop-specific Average Crop Revenue Election programme, which can be triggered even when commodity prices are high, further distorts production decisions. Also, in responding to climate change concerns, the United States have set mandatory fuel standards to increase the share of renewable sources in overall fuel use, the European Union Council has adopted a biofuel consumption target for transportation, and a number of other OECD countries have taken actions along similar lines. This, along with

Table 2.4. **Progress made in countries with recommendations to reform agricultural support policies**¹

	2005-2008				2009					
	Action taken	Action taken implying removal of the priority	No significant measure	Policy relapse	Reviews/laws announced	Public consultation	Legislation concluded	Other measures	No significant measure	Policy relapse
Agricultural support										
European Union			X	X					X	X
Iceland	X								X	
Japan	X								X	
Korea			X						X	
Norway			X						X	
Switzerland	X								X	
United States			X	X					X	

1. The table covers only countries with policy recommendations in the area listed. The first set of columns titled “2005-2008” give a synopsis of the progress on 2005 *Going for Growth* priorities in 2005 and 2006 and on 2007 priorities in 2007 and 2008. Similarly, the last set of columns titled “2009” relate to progress on 2009 *Going for Growth* priorities in 2009.

the erection of import barriers to foreign biofuels, has *de facto* put upward pressure on the prices of agricultural products, and has been found to be a very costly means to achieve emissions reduction objectives (OECD, 2008b). In Japan, the government has decided to allow the entry of joint-stock companies into agriculture on a nation-wide basis on leased land, and to concentrate more of the financial support on larger, more efficient farms. The system of administered prices for wheat and barley has also been relaxed. In Switzerland, support has shifted towards more market-friendly instruments. It has been decided to eliminate the milk quota system and trade barriers *vis-à-vis* European Union countries for a few agricultural products. In Iceland, excise taxes on imported food (other than sugar and sweets) have been abolished, and the general import tariff on imported meat products has been lowered significantly with a view to reducing prices. Little progress has been made in Norway and Korea.

Other policies

Policy priorities have also covered a broad range of other areas relevant to productivity performance, some of which – especially in the financial sector, though also in the areas of public sector efficiency and international trade – appear to be especially important at the current juncture for a sound economic recovery and public finance consolidation :

- *External exposure.* Of the five countries which have been diagnosed with a particular policy weakness on this front, all except Mexico have taken some corrective measures since 2005, and in three cases the priority was subsequently removed (Korea, Poland and Switzerland). Reforms have included changing commercial law to facilitate mergers and acquisitions by foreign companies (Japan), creating free economic zones to attract foreign firms (Korea), simplifying procedures for non-residents to set up a business, easing ownership restrictions and providing investors with a binding legal interpretation of existing provisions (Poland), lowering non-tariff barriers (Switzerland), and relaxing existing residency requirements for directors of financial institutions and (in 2009) foreign ownership restrictions (Canada). New Zealand has raised the firm size threshold beyond which consent is required for foreign acquisitions, but also tightened entry

barriers for investment in infrastructure on strategically sensitive lands. Most recently, the crisis has raised concerns that backward steps could be taken in this area across the OECD. Available evidence thus far suggests that some *de facto* protectionist measures have indeed been enacted but remain limited in depth and scope (see Box 1.2 in Chapter 1).

- *Public-sector efficiency.* Nine out of the eleven countries identified as in need of reform in this area have taken some action since 2005, and the policy priority was dropped as a result in four cases (Germany, Luxembourg, Portugal and Turkey). The measures implemented have involved re-organisation of health services and the introduction of fees to enhance cost awareness in health care (the Czech Republic and Hungary), increased competition in government procurement by issuing calls for tenders more widely and simplifying rules (Germany), consolidating a number of ministries and the regional network of public offices, reducing excessive numbers of civil servants and increasing the accountability and transparency of government agencies (Hungary in 2009), tightening the regulations governing budget implementation (Iceland), reforming public sector employment by aligning employment conditions with those prevailing in the private sector (Portugal), introducing results-oriented budgeting in public services (Turkey), increasing competition from the private sector in the provision of publicly-funded services and reforming performance management (the United Kingdom), enhancing the cost-effectiveness of regional policy by substituting regionally differentiated employers' social security taxes for less targeted measures (Norway), and introducing e-government (Luxembourg). New Zealand announced a plan to link tertiary institution funding more closely with performance in 2009. No significant progress has been registered in Canada.
- *Innovation-promoting policies.* All three countries concerned followed up on *Going for Growth* recommendations since 2005 in the form of additional public support for R&D activities (Ireland), measures to facilitate the mobility of researchers and increase the use of competitive grants (Japan), and more rigorous protection of intellectual property rights and improvements in the quality of tertiary education (Korea).
- *Public infrastructure.* Addressing public infrastructure deficiencies has been called for in Ireland, New Zealand, Poland and the United Kingdom. Prior to the ongoing economic crisis, all four countries responded by increasing spending levels. These efforts would need to be sustained to achieve decisive improvements in the quality of infrastructure, but Ireland decided to cut spending to improve the sustainability of public finances in 2009, while most other OECD countries raised expenditures as part of their fiscal stimulus packages (see Tables 1.1 and 1.2 in Chapter 1).
- *Tax system.* Simplifying the tax system, reducing distortions and/or broadening the tax base has been identified as a priority for Canada, Greece, Mexico, Portugal, the United States, and Japan more recently (2009). The first four countries have taken substantial measures since 2005. In Canada, the federal government has decided to reduce the corporate income tax and to eliminate its capital tax and the corporate surtax, while in 2009 the governments of British Columbia and Ontario announced they would harmonise their sales tax with the federal value-added tax. In Greece and Portugal, measures to fight tax evasion have been taken. In Mexico, the income tax has been simplified and the tax base has been broadened.

- *Rule of law.* Strengthening the judicial system and law enforcement has been identified as a priority in Hungary, the Slovak Republic and Mexico. Only the first two countries have made some progress on this front since 2005, and no further measures have been initiated in 2009.
- *Financial sector.* Financial sector reform was identified as a policy priority for Japan and Korea in the first issue of *Going for Growth*, and both countries quickly followed through. In Japan, government policy helped to address non-performing loan problems at major banks, and the Japan Post was privatised.³ In Korea, the government made considerable strides in the privatisation of banks and investment trust companies. Following the financial crisis, financial sector reform became a *Going for Growth* priority for Iceland and the United States in 2009, and the US government has since taken steps towards overhauling the financial supervision and regulatory system. More broadly, financial sector reform is needed and is currently underway in most OECD countries.

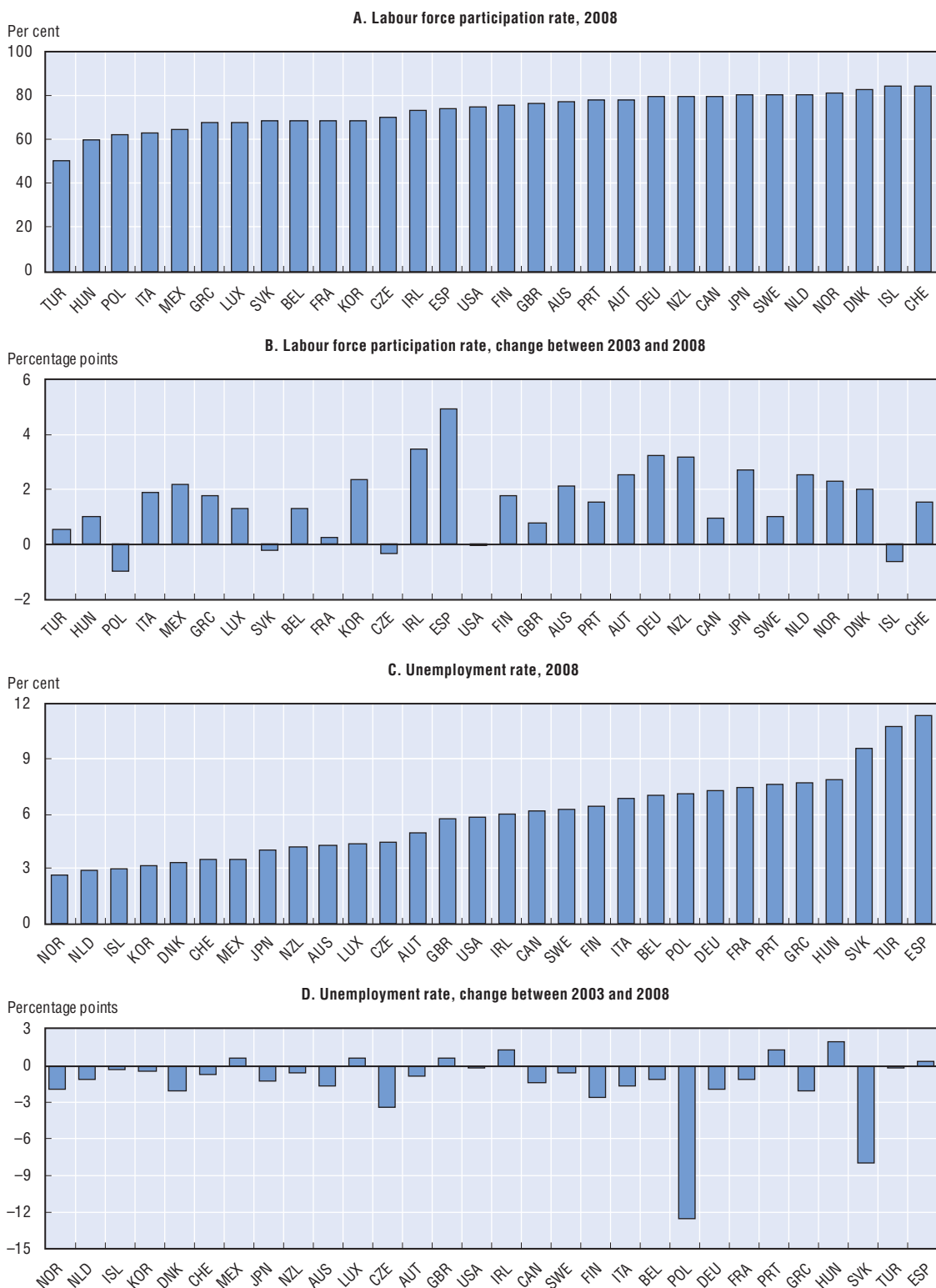
Progress in reforming policies to improve labour utilisation

Since 2005, recommendations to remove impediments to labour utilisation have been made primarily to Continental European countries, where trend labour utilisation rates remain comparatively low despite some noticeable progress prior to the recent crisis (Figure 2.3). Identified policy priorities have included reducing disincentives to work at older ages, obstacles to female participation and labour tax wedges, as well as improving the design of disability and sickness benefit schemes and other labour market policies such as employment protection legislation and unemployment benefits. Priorities have also been identified in these areas outside Europe, as a way to address more specific labour market performance weaknesses. Most countries have taken action since 2005, but deficiencies remain which, if unaddressed, risk turning some of the crisis-related fall in employment into a persistent decline.

Financial disincentives to work at older ages

There has been some modest progress since 2005 – but not in 2009 – in reducing financial disincentives to work at older ages embedded in old-age pension systems and/or available social transfer programmes where this was deemed a policy priority (Table 2.5). Some of the reforming countries phased out or restricted access to early retirement schemes by tightening eligibility conditions (Belgium, Denmark, Finland, Germany and Spain). Others indexed the minimum retirement age to life expectancy (Denmark), sought to increase the effective retirement age by enhancing financial incentives to work beyond the statutory age (Belgium, Finland, France, Germany, Greece and Spain), lengthening contribution requirements to claim full pensions (Belgium, France and Spain), or adjusting benefits in line with life expectancy (Norway). As a result, the priority was dropped for Denmark, Germany, Norway and Spain. Greece launched a public consultation on pension reform in 2009. In Norway, however, the government later weakened the reform by deferring the life expectancy adjustment of pension benefits. In Luxembourg and the Slovak Republic, no significant measures have been carried out, and in Austria some aspects of the 2003-2004 pension reform have been reversed, reducing the penalty rate for early retirement and extending the special early retirement scheme. As the post-crisis recovery unfolds, further reductions of financial disincentives to continued work, not least faster phasing out of special or *de facto* early retirement routes, including *via* disability and

Figure 2.3. Labour force participation rates and unemployment rates



Source: OECD, Economic Outlook 86 Database.

StatLink <http://dx.doi.org/10.1787/786610417714>

sickness systems, would help to ensure that older workers who have suffered from crisis-related lay-offs remain attached to the labour market.

Table 2.5. Progress made in countries with recommendations to reform disability and sickness systems, remove disincentives to work at older ages, or reduce impediments to female participation¹

	2005-2008				2009					
	Action taken	Action taken implying removal of the priority	No significant measure	Policy relapse	Reviews/laws announced	Public consultation	Legislation concluded	Other measures	No significant measure	Policy relapse
Reduce implicit tax on continuing to work and work at older age										
Austria			X	X					X	
Belgium	X								X	
Denmark		X			-----	n.a.	-----			
Finland	X								X	
France	X								X	
Germany		X			-----	n.a.	-----			
Greece	X					X				
Luxembourg			X						X	
Norway		X			-----	n.a.	-----			
Slovak Republic			X						X	
Spain		X			-----	n.a.	-----			
Turkey	X								X	
Reform disability and sickness benefits										
Australia	X								X	
Denmark	X					X				
Hungary	X					X				
Netherlands	X								X	
Norway	X					X				
Poland		X			-----	n.a.	-----			
Sweden	X								X	
Switzerland		X			-----	n.a.	-----			
United Kingdom	X					X				
United States			X						X	
Reduce implicit tax on returning to work following child birth										
Austria	X								X	
Germany	X								X	
Ireland	X					X				
Korea	X					X				
Netherlands	X								X	
New Zealand	X								X	
Slovak Republic	-----	n.a.	-----						X	
Switzerland	X								X	
United Kingdom	X								X	

n.a.: Denotes that the corresponding priority was not yet introduced over the period considered, or was dropped following commensurate actions taken.

1. The table covers only countries with policy recommendations in the area listed. The first set of columns titled "2005-2008" give a synopsis of the progress on 2005 *Going for Growth* priorities in 2005 and 2006 and on 2007 priorities in 2007 and 2008. Similarly, the last set of columns titled "2009" relate to progress on 2009 *Going for Growth* priorities in 2009.

Disability and sickness benefit schemes

Disability and sickness benefit schemes have been subject to reform since 2005 in nine out of the ten countries concerned, although only in the case of Poland and Switzerland was action taken followed by a removal of the priority (Table 2.5). Some countries have sought to better discriminate between recipients depending on their work capacity. One approach has been to increase economic incentives to work (partially linking benefit levels and the earnings capacity of benefit recipients in the Netherlands). Another approach has been to adjust or enforce eligibility criteria, either through tighter work obligations or eligibility conditions for new claimants (Australia, Poland, Switzerland and, in 2009, the United Kingdom), or *via* increased emphasis on rehabilitation and work capacity assessment (Denmark in 2009, Hungary in 2009, the Netherlands and Switzerland). Other countries have reduced the incentives for employers and recipients to over-use the schemes (introduction of/or increase in employers' financing of disability and sickness benefits in the Netherlands and Sweden; reduction of the maximum wage subsidy under the Flexjob scheme in Denmark). In Norway, participants in the long-term sickness and disability benefit schemes are now more closely followed, and the ongoing merger of the welfare system and the employment services network is intended to improve co-ordination of these services. Finally, Poland and Sweden have restricted the duration and amount of benefits.

Impediments to full-time female labour participation

Some of the impediments to full-time female participation have been reduced since 2005 in all eight countries where this was put forward as a policy priority. This was achieved by expanding childcare facilities through subsidies (Germany, Ireland, Korea and New Zealand), lowering the compulsory schooling age or promoting full-day schools (Germany and Switzerland), and reducing marginal tax rates on second earners (Austria, Ireland, the Netherlands, Switzerland and the United Kingdom).

Labour taxation

Of the 13 countries for which reforms of labour taxation have been advocated, nine took some remedial actions between 2005 and 2008. However, in no case were the measures taken extensive enough to warrant a reconsideration of the policy priority, reflecting in part the difficulty to achieve major but still fiscally sustainable tax cuts over a relatively short time period (Table 2.6). Average and/or marginal tax wedges were reduced across the board mainly through lower income tax rates and/or higher exemption levels (Belgium, the Czech Republic, Denmark, Italy and Poland). More frequently, the cuts were targeted at the low-skilled, in the form of reductions in social security contributions (Austria, Belgium, Italy, Poland, Sweden and Turkey) or in-work tax credits (Belgium and Sweden). Germany lowered social charges, and reforms of unemployment insurance and pension systems will help sustain lower contributions in the future. While these cuts were offset by an increase in indirect taxes (the VAT rate), the associated shift in the tax structure from labour to consumption taxes should still benefit longer-term growth (see Johansson *et al.*, 2008). In Hungary, a pressing need to consolidate the budget resulted in an increase in the tax wedge, although this was accompanied by a smoother marginal tax schedule.

Labour taxation reforms have been widespread throughout 2009, mostly as part of the recent fiscal stimulus packages. Countries that had been encouraged to cut tax wedges

Table 2.6. **Progress made in countries with recommendations to reduce labour taxation and reform labour market policies**¹

	2005-2008				2009					
	Action taken	Action taken implying removal of the priority	No significant measure	Policy relapse	Reviews/laws announced	Public consultation	Legislation concluded	Other measures	No significant measure	Policy relapse
Lower labour taxes										
Australia	X				X					
Austria			X				X			
Belgium	X						X			
Czech Republic	X								X	
Denmark	X						X			
Finland			X				X			
Germany	X								X	
Greece	-----	n.a. -----							X	
Hungary	X			X			X			
Italy	X								X	
Norway	-----	n.a. -----							X	
Poland	X						X			
Slovak Republic			X				X			
Sweden	X								X	
Turkey	X						X			
Review wage formation or minimum cost of labour										
Australia			X	X					X	
Belgium			X						X	
Finland			X						X	
France			X						X	
Greece			X						X	
Italy			X						X	
Poland			X	X					X	
Spain			X						X	
Turkey	X								X	
Reform employment protection legislation										
Czech Republic			X						X	
France	X								X	
Germany	-----	n.a. -----							X	
Greece	X								X	
Japan			X						X	
Korea			X						X	
Luxembourg			X						X	
Netherlands	-----	n.a. -----							X	
New Zealand	X								X	
Portugal	X								X	
Spain			X						X	
Sweden	X								X	
Turkey			X				X			
Reform unemployment benefits										
Belgium	-----	n.a. -----							X	
Canada			X						X	
Finland	X								X	
Luxembourg			X						X	
Activation of long-term unemployed										
Belgium		X			-----	n.a. -----				
Germany			X						X	
Netherlands			X						X	
New Zealand		X			-----	n.a. -----				
Slovak Republic	-----	n.a. -----					X			

n.a.: Denotes that the corresponding priority was not yet introduced over the period considered, or was dropped following commensurate actions taken.

1. The table covers only countries with policy recommendations in the area listed. The first set of columns titled "2005-2008" give a synopsis of the progress on 2005 *Going for Growth* priorities in 2005 and 2006 and on 2007 priorities in 2007 and 2008. Similarly, the last set of columns titled "2009" relate to progress on 2009 *Going for Growth* priorities in 2009.

have reduced income tax rates and/or increased tax relief (Austria, Denmark, Finland, Hungary and Poland), introduced or raised in-work tax credits (Denmark and the Slovak Republic), lowered social security contributions (Finland, Hungary and Poland) and increased wage subsidies (Belgium). In the same period, Australia has undertaken a review of the tax system and its interaction with the welfare system. In Turkey, social contribution rates have been reduced, albeit temporarily.

Labour market policies

Little has been done since 2005 to address priorities in most other labour market policy areas, including wage formation, employment protection legislation and unemployment benefit systems. One exception is the field of active labour market policy, where priorities have typically been dropped as a result of more significant policy action.

- *Wage formation.* Of the nine countries where reducing the minimum cost of labour or making wage bargaining more flexible has been seen as a priority, only Turkey has taken action since 2005 by cutting social security contributions for low-wage earners (Table 2.6). In Australia, the 2006 reform of the wage bargaining system has been partly reversed. In Poland, the new indexation rule is likely to result in an increase in the minimum wage relative to the average wage.
- *Employment protection.* Reforms have also been limited in the area of employment protection legislation, where some easing has been suggested where existing provisions were deemed excessively stringent. Only five out of the 11 countries subject to a recommendation have taken significant action since 2005, with no specific action taken in 2009, and only Portugal, New Zealand and – to a lesser extent – Greece focused on permanent contracts (Table 2.6). Dismissal procedures have been substantially simplified in Portugal. In New Zealand, a trial period of 90 days for new employees in businesses with fewer than 20 staff has been introduced. In Greece, permanent contracts for new employees in all public enterprises and entities, as well as a rule which allowed collective dismissals of only 2% of the workforce per month for medium-sized firms, have been abolished. Elsewhere, only partial reforms targeted at temporary contracts have been carried out. France reduced the frequency of cases requiring a court ruling in return for higher severance payments, and introduced a new fixed-term contract for specific projects. Sweden eased the rules for temporary contracts so that these can be used without particular reason and longer than previously (24 months instead of 12).
- *Unemployment benefits.* The reform of income support schemes for the unemployed has been a priority in Canada, Finland and Luxembourg since 2005 (Table 2.6). While no significant progress has been made in Luxembourg, Canada has introduced an earned-income tax credit to increase work incentives, and Finland has made receipt of unemployment benefits after 500 days conditional on participation in active labour market programmes. However, in 2009 Finland temporarily raised unemployment benefits in the context of the economic crisis, and Belgium raised initial unemployment benefit levels and increased benefits for workers on reduced working time (*chômage temporaire*). A number of other OECD countries have taken crisis-response measures along similar lines, some of which would need to be reconsidered as the labour market situation improves, or be balanced by active labour market policies (see Chapter 1).
- *Activation of the long-term unemployed.* Since 2005, some efforts to strengthen the efficiency of active labour market policies have been made in Belgium, New Zealand and

– in 2009 – the Slovak Republic, but not in Germany (after the 2005 Hartz reforms) where this has also been identified as a priority (Table 2.6). In New Zealand, the government introduced a single core benefit that would apply one set of criteria to all working-age beneficiaries and deliver employment assistance based on their work capacity, rather than their benefit category. In Belgium, co-ordination between the regional placement agencies has been improved by creating an interregional association to exchange job offers and through increased co-operation in the field of training. The Slovak Republic has taken action by strengthening the competency of the Public Employment Service.

Other policies

Remaining priorities aimed mainly at enhancing labour utilisation have focused on health care costs – as a way to lower tax wedges – and housing policies – in order to enhance labour mobility.⁴ As regards health care, Switzerland has benchmarked reimbursements for pharmaceuticals more closely to generic products in order to bring costs under control. In the United States, the extension of Medicare prescription drug coverage to all seniors without accompanying cost-saving measures has put further upward pressure on costs. In 2009, the US government has announced plans to overhaul the health care sector by, *inter alia*, lowering drug costs and speeding up the adoption of health care information technology.

Of the 11 countries where a removal of distortions in housing policies has been recommended, six have taken action since 2005. Policy measures have included easing residential zoning and planning regulations (the United Kingdom, where the boundaries of the “green belts” that restrict the supply of land for commercial and housing development in fast-growing areas are also under review, and the Netherlands to some extent), relaxing rent regulation (the Czech Republic and Sweden), curbing the tax advantages of home ownership (Spain to some extent), restricting housing-loan subsidies and making them portable (Hungary in 2009), or introducing new courts and accelerated procedures to enhance the enforcement of rental contracts (Spain). Sweden has cut rental housing subsidies but eased taxation on owner-occupiers. Denmark, Iceland, Poland and the Slovak Republic have taken no significant steps forward since 2005, and Ireland eased housing taxation *de facto* by raising the price threshold below which first-time buyers of existing dwellings are exempt from stamp duty.

Summing up overall reform patterns

In order to identify and assess broad reform patterns across the OECD since the first issue of *Going for Growth*, two alternative indicators are constructed for each individual priority area, each broad reform field (labour-productivity or labour-utilisation enhancing reforms) and each individual country (see Annex 2.A1 for details):

- An annual “responsiveness rate”, based on a scoring system under which each possible reform opportunity (*i.e.* whenever a priority was set in the previous edition of *Going for Growth* for the individual policy area considered) takes value 1 if significant action is taken the following year, and 0 otherwise. The responsiveness rate is therefore calculated as the ratio of the total number of years in which some action towards addressing the policy weakness is taken to the total number of years in which some action could potentially be taken – which by definition excludes the year when the policy priority is first set and the years before.

- A “follow-through rate”, a measure of deep reforms based on a scoring system which for each possible reform opportunity takes value 1 if any action taken is significant enough for the corresponding priority to be dropped in the following *Going for Growth* exercise, and 0 otherwise. It is basically the ratio of the number of priorities dropped following significant action during the previous two years to the total number of two-year *Going for Growth* cycles in which the policy recommendation appears. Priorities dropped following significant action are determined based on previously published information (see Box 2.3 in *Going for Growth 2009*). The follow-through rate cannot be readily compared with the responsiveness rate since it is computed over a two-year rather than one-year period, and only over the period 2005-2008 – rather than 2005-2009 – covered by the 2005, 2007 and 2009 issues.

Both indicators measure the extent to which OECD countries have followed up on *Going for Growth* recommendations since 2005, with the latter setting a more stringent criterion – a subsequent removal of the priority – than the former to define action taken. Neither aims to assess overall reform intensity *per se*, which would require both accounting for reforms carried out in non-priority areas and quantifying the importance of each individual measure. Also, these indicators are imperfect substitutes for reform assessments based on the quantitative and internationally comparable OECD structural policy indicators that underlie *Going for Growth*. Nevertheless, they are used here mainly because of their greater comprehensiveness and timeliness (see Box 2.2 and Annex 2.A1 for an overview of the limitations of the responsiveness and follow-through indicators, and Box 2.3 for a discussion of the matching between these and OECD structural policy indicators).

Box 2.3. Structural policy versus subjective reform indicators

The retrospective reform assessment undertaken in this chapter relies on qualitative assessments which have several important advantages in the specific context of this analysis over the quantitative information supplied by the OECD’s internationally comparable structural policy indicators:

- They allow comprehensive coverage of all reforms undertaken in priority areas since 2005. Relying instead on the OECD structural policy indicators would restrict the analysis to indicator-based priorities and exclude many other (non indicator-based) key priorities that in the 2009 *Going for Growth* exercise accounted for around 20% of all priorities.
- They are up-to-date and allow tracking reforms in real time, including most recent (2009) information on early stages of reforms. By contrast, many of the key OECD structural policy indicators (e.g. employment protection legislation or product market regulation indicators) are not updated on a continuous basis, reflecting the time required and resources needed for this matter. Furthermore, in a few cases the quantitative indicators used in *Going for Growth* so far capture outcomes rather than policy settings, and/or convey lagged information by construction. This is the case for instance of the educational attainment indicators used in the area of human capital, or the aggregate spending indicators used in the area of health.
- They are readily built upon, and thereby help summarise the qualitative information from previous *Going for Growth* editions in a systematic and straightforward manner. They allow the construction of summary reform indices covering all *Going for Growth* areas, with symmetric treatment of indicator-based and non-indicator based priorities.

Box 2.3. Structural policy versus subjective reform indicators (cont.)

It is, nevertheless, useful to assess the extent to which the qualitative information on reforms provided in all *Going for Growth* issues since 2005 matches the (changes in) OECD structural policy indicators. The approach followed here is to explore the correlation between qualitative and quantitative reform indices for the three *Going for Growth* priorities supported by indicators over 2005-2008. To this end, a binary variable that takes value 1 when there is improvement in the value of the quantitative policy indicator and 0 otherwise is constructed. This binary variable is then compared with the binary variable that provides the basic information used to compute the responsiveness rate, i.e. a binary variable that takes value 1 when some legislative action is taken and 0 otherwise.

The overall match between these binary quantitative and qualitative reform indicators is at best moderate. They provide consistent messages in 61% of the cases, meaning that for 61% of the reform opportunities considered in the analysis, (no) significant action according to the qualitative indicator is matched by some (no) improvement in the corresponding quantitative indicator (see the table below). The limited match between the two types of indicators is to be expected. In particular:

- While the qualitative reform indicators provide ideally all relevant information on reform efforts over the period 2005-2008, most OECD structural policy indicators by their very nature cover only partly or inexactly the period of interest.¹
- There are typically lags between decisions and actions, and reform implementation is often spread over several years. As a result, changes in OECD structural policy indicators between 2005-2008 are likely to capture only incompletely the legislative actions taken during this period, while at the same time reflecting in part the gradual effects of earlier reforms.² Both factors are sources of mismatch between the quantitative reform indicators and their more coincident qualitative counterparts
- By construction, the qualitative reform indicators do not reflect deteriorations in policy stances or reversals of reforms (see Annex 2.A1). In cases where legislative action is taken and then reversed (partially or fully) throughout the period under consideration, unlike the quantitative indicators the qualitative indicators capture only the progress recorded but not the subsequent policy relapse – as the latter is scored zero rather than minus one by assumption. In fact, when an alternative binary qualitative indicator is used which also accounts for deteriorations in policy settings – i.e. which takes value 1 only if action is taken and not followed by backtracking, the correlation between this new indicator and the binary quantitative indicator improves and becomes significant at the 5% confidence level.

Match between the information content of OECD structural policy indicators and the qualitative reform indicators used in this chapter

	Some action taken	No action taken
Improvement in the corresponding structural policy indicator	49	23
Deterioration or no change in the corresponding structural policy indicator	16	15

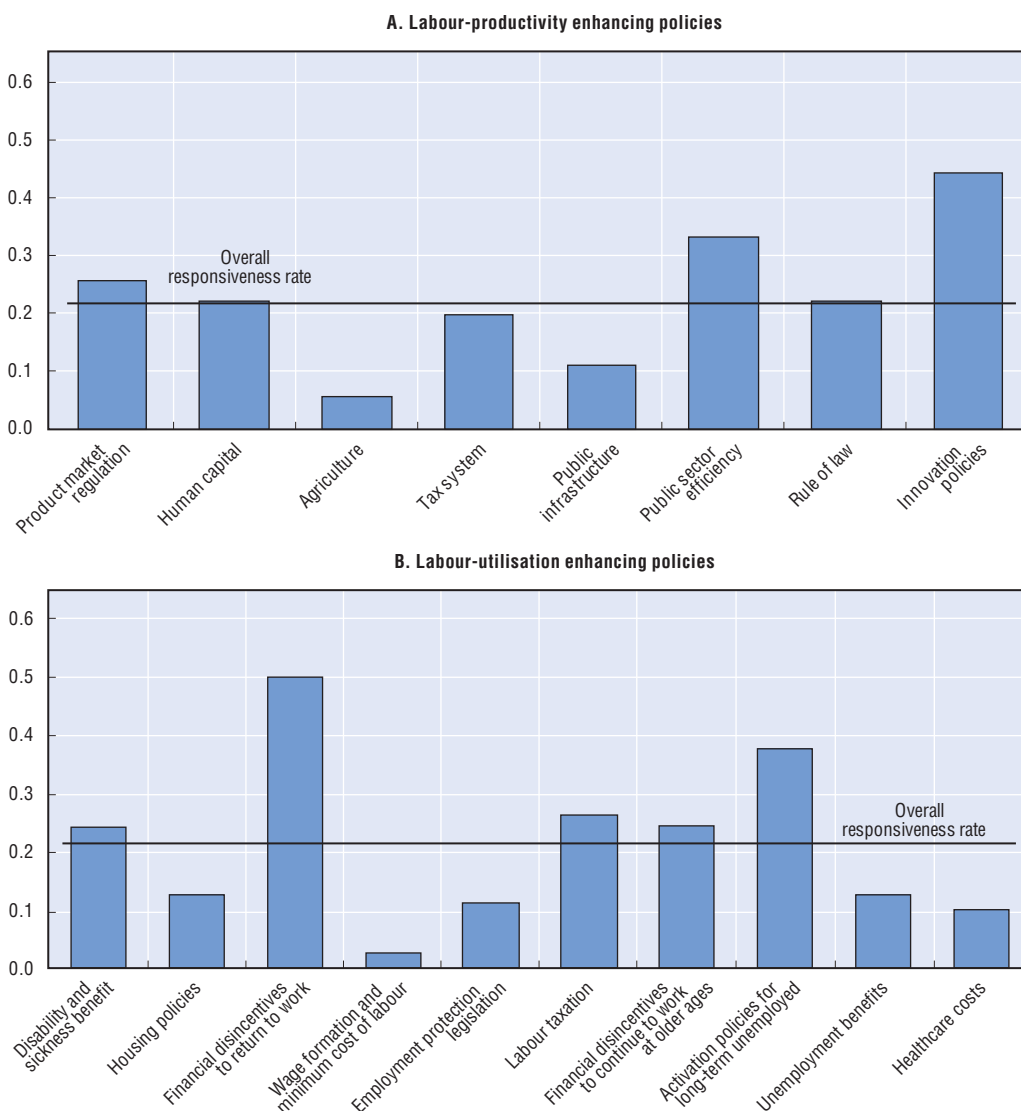
1. For instance, 2003 and 2008 vintages of product market regulation indicators, and 2004 and 2006 vintages of disability benefits recipients data are taken to approximate the change in policy settings between 2005 and 2008, which is less than ideal. When the latest available vintages of the indicators are too old or the two successive data points would potentially be widely misleading as a measure of change in the indicator between 2005 and 2008, those policy priorities are not included in the comparison and the calculation of the correlation coefficient reported in the table above.

2. This may explain in part the 23 mismatches mentioned in the upper-right cell of the table featured in this box.

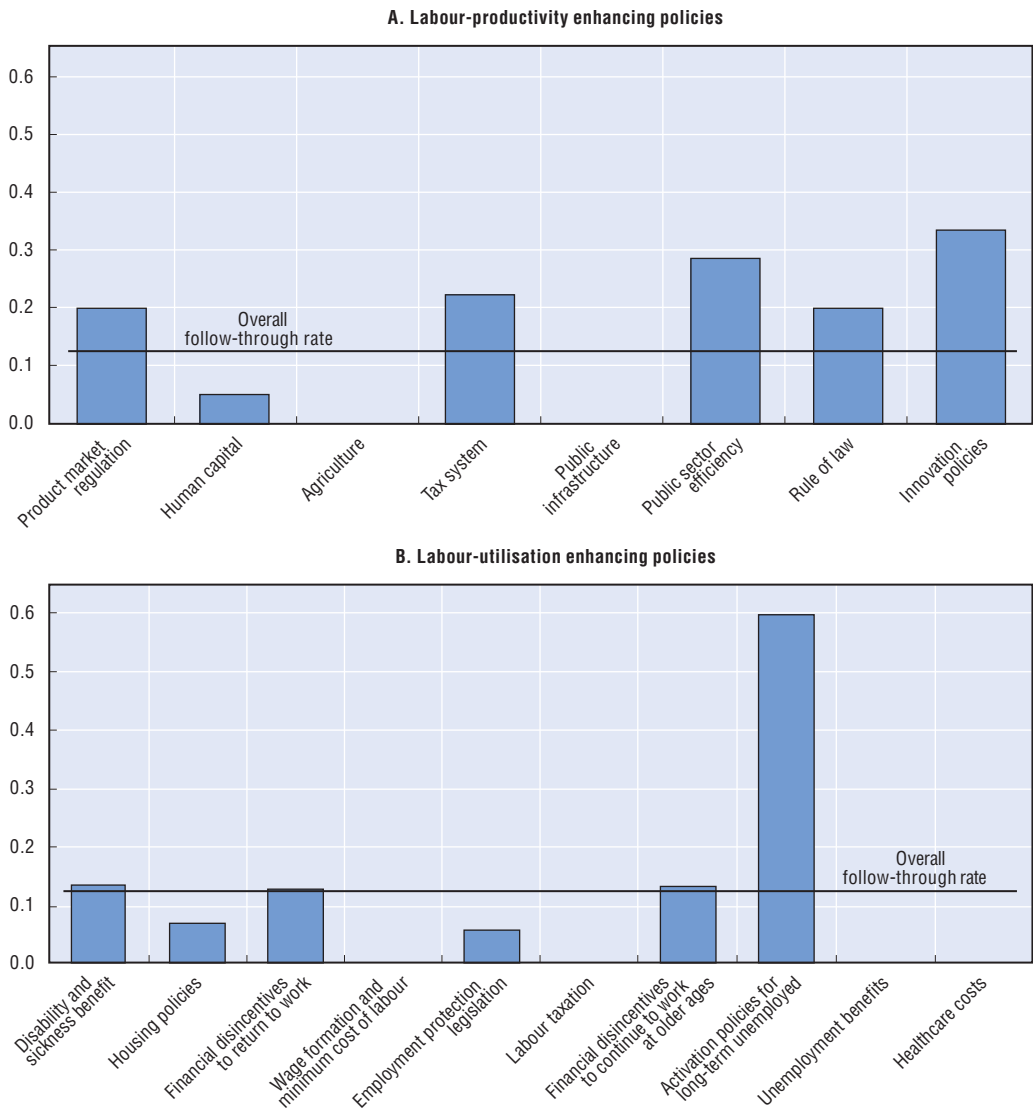
Reform patterns across fields


Based on these indicators, OECD countries appear to have followed up on *Going for Growth* recommendations to a greater extent in labour-productivity enhancing reform areas than in labour-utilisation enhancing ones since 2005 (Figures 2.4 and 2.5). Policy responses to priorities aimed at boosting productivity levels have been strongest in the areas of innovation policy and public sector efficiency, and weakest on agricultural support policies. Actions taken to raise labour utilisation have been most widely seen in the fields of labour taxation, active labour market policies, and retirement and disability and sickness schemes, while little has been done to reform employment protection legislation, wage formation, unemployment benefits, housing policies and health care systems. These findings are consistent with previous OECD analysis of labour market reform intensity carried out as part of the reassessment of the *OECD Jobs Study* (Brandt *et al.*, 2005). In

Figure 2.4. **Responsiveness to *Going for Growth* recommendations across reform areas since 2005**



StatLink  <http://dx.doi.org/10.1787/786610417714>

Figure 2.5. **Follow-through of Going for Growth recommendations across reform areas since 2005**

StatLink  <http://dx.doi.org/10.1787/786610417714>

particular, the overall evidence supports the view that reform is easier to undertake where it entails only benefits and little or no short-term cost (e.g. labour tax cuts, increased spending on active labour market or innovation policies), and harder to carry out where it may hurt the short-term interests of specific groups (e.g. farmers and permanent workers, under agricultural support policies and job protection reforms, respectively).

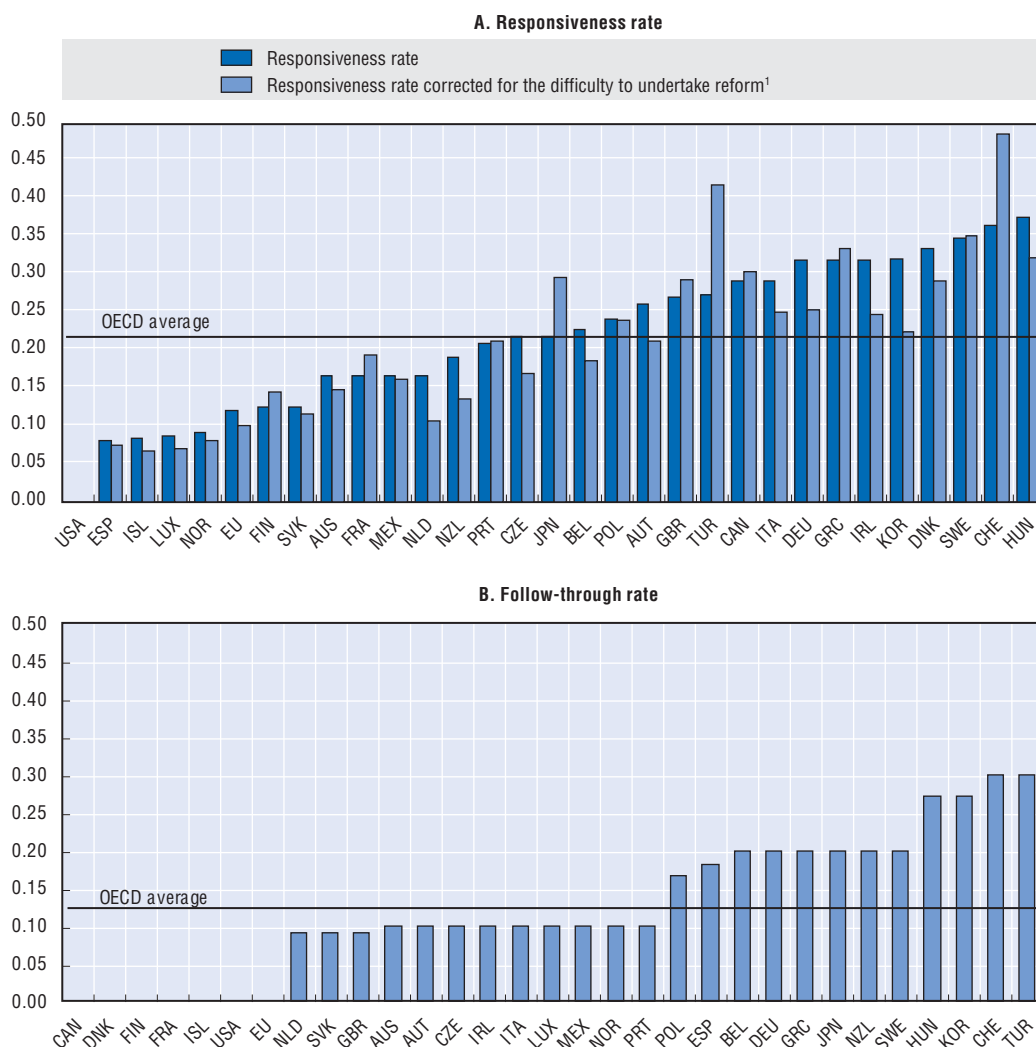
Also, while action has been relatively frequent in the *Going for Growth* priority areas, it has rarely been followed by a removal of the policy priority, hinting at some lack of major reforms. The follow-through rate is much lower than the responsiveness rate – all the more so when account is made for the fact that it assesses reforms on a two-year cycle rather than on an annual basis. Still, both indicators usually convey consistent messages across fields, except in areas where sustained reform efforts, and not just measures carried out over a couple of years, are often required to address the priority (e.g. cuts in labour tax

wedges, which in order to be sizeable and permanent need to be financed through reductions in public spending, or education reforms which improve human capital only with long lags).

Reform patterns across countries

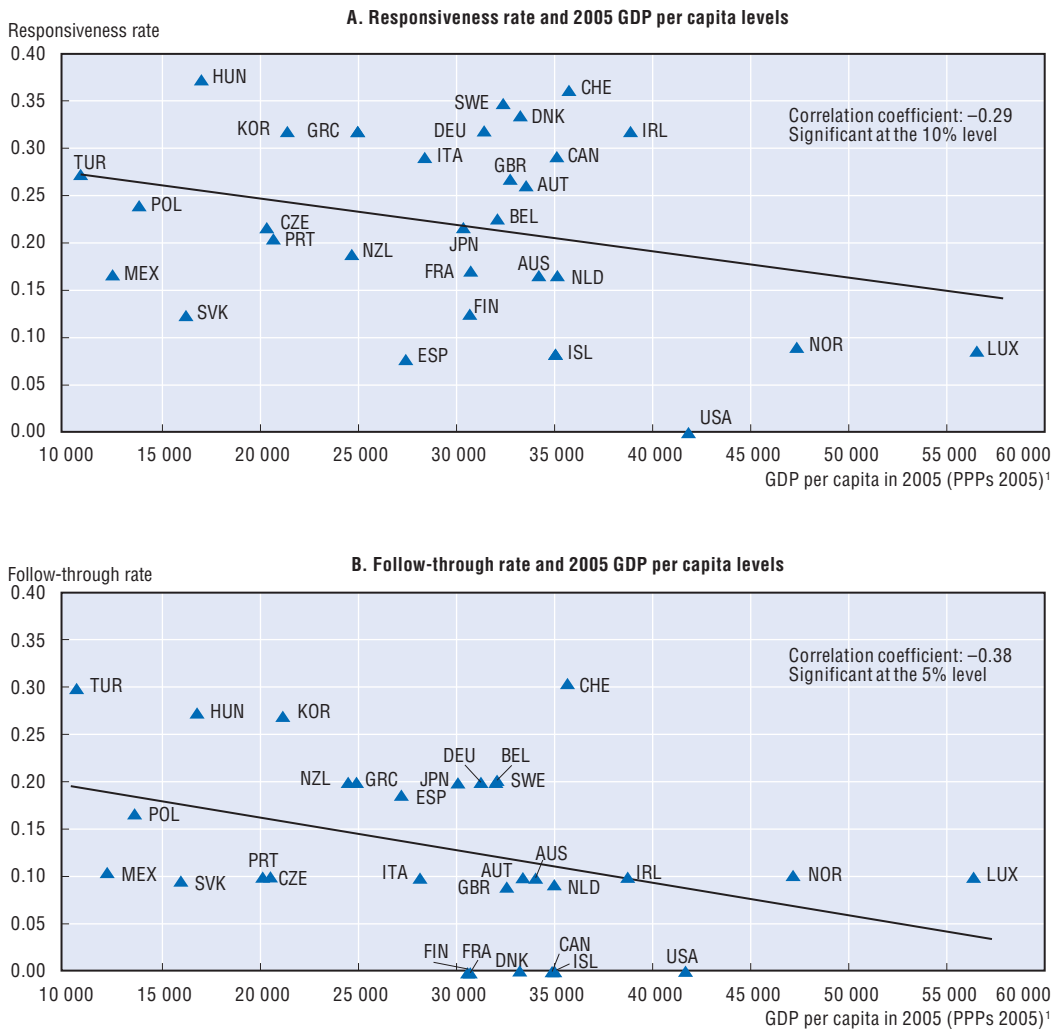
Countries that have been most active in reforms since 2005 are quite dispersed in terms of geography, size and income levels, although a majority are small OECD economies (Figure 2.6). More active countries have typically taken measures in a broader range of *Going for Growth* priority areas and have experienced greater turnover in priorities. There is only a weak link between the need for reform and subsequent reform activity, i.e. those countries that had lower GDP per capita levels in 2005 have, on average, only mildly been more responsive to *Going for Growth* priorities (Figure 2.7).⁵

Figure 2.6. **Responsiveness to and follow-through of *Going for Growth* recommendations across countries since 2005**



1. See Annex 2.A1 for details.

Figure 2.7. Initial income levels and subsequent progress in reforms



1. 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.

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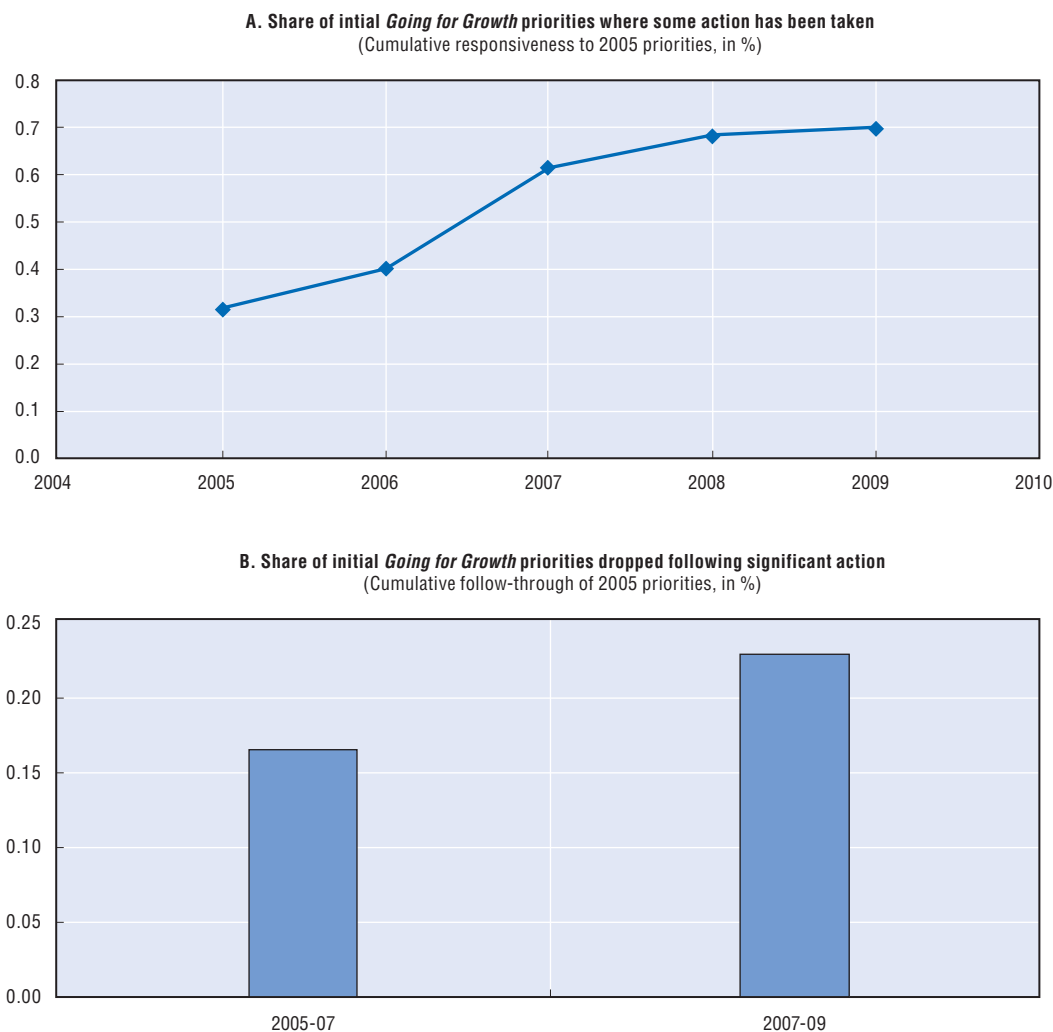
Because some policy areas appear to be more difficult to reform than others (see Figures 2.4 and 2.5), the extent to which countries have followed up on *Going for Growth* priorities may also be shaped by the nature of the recommendations. For instance, a country subject to recommendations in the areas of innovation and public sector efficiency might be expected to be more responsive than another country with similar appetite for reform but with priorities in the areas of EPL and wage formation. In order to account for this possibility, a “corrected” responsiveness rate is computed, which weighs responsiveness on each individual priority according to the difficulty to undertake reform in the corresponding field – as measured by the overall responsiveness to priorities in this area across the OECD (see Annex 2.A1 for details). The overall picture is not widely affected (Figure 2.6). Nevertheless, “corrected” responsiveness is significantly higher in a few countries where action since 2005 has focused on challenging reform fields (e.g. Japan, Sweden, Switzerland, Turkey), and lower where measures have been targeted at areas


where political resistance to reform is likely to be weaker (e.g. Austria, the Czech Republic, Germany, Ireland, Korea, the Netherlands, New Zealand).

Reform patterns over time

Finally, countries appear to have been more responsive to *Going for Growth* recommendations when looking over longer time spans. This confirms that proposing, negotiating, adopting and implementing reforms is often a lengthy process. For instance, while on average less than one-third of 2005 *Going for Growth* priorities had been followed by significant action by 2006, that share increased to almost two-thirds by 2008, although it appears to have levelled off since then. (Figure 2.8, Panel A). Likewise, the share of the initial 2005 priorities that have been dropped has been increasing over time (Figure 2.8, Panel B). The recent crisis does not seem (at least so far) to have accelerated the pace of structural reform, with average responsiveness rates across the OECD having been approximately halved between 2006-2007 and 2008-2009. This may reflect to some extent a

Figure 2.8. **Cumulative action taken OECD-wide on 2005 *Going for Growth* priorities since their introduction**



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temporary shift in countries' priorities towards macroeconomic policy issues, as well as the difficulty to launch reforms – such as in the area of labour markets – that could have further depressed demand and activity at the start of a crisis.

Notes

1. While the focus of this and the opening chapter is on OECD member countries only, a special chapter (Chapter 7) discusses structural policy challenges and reform priorities for the five countries with which the OECD pursues “enhanced engagement” (Brazil, China, India, Indonesia and South Africa), preparing the ground for their full integration into *Going for Growth 2011*.
2. These gaps in GDP per capita have been persistent over time in most countries, although they have changed in a couple of cases as a result of the crisis. In particular, the gaps for Iceland and Ireland have widened markedly in 2009.
3. Although Japan Post was privatised according to the SNA classification, the government still holds all the equity, and as a result privatisation is not yet effective in terms of ownership or legal control. The Japan Post holding company has to divest the banking and insurance subsidiaries by 2017 while keeping all the equities of the two postal service subsidiaries.
4. Housing policies can in fact be considered as policies aimed at improving labour utilisation or productivity, depending on the nature of the recommendations. While most housing-related *Going for Growth* priorities have aimed to enhance labour mobility, some recommendations – such as a reduction in the favourable tax treatment of owner-occupied housing – have primarily sought to improve the efficiency of resource allocation and thereby productivity.
5. The strength of the link between the initial conditions and subsequent reform performance does not improve substantially when i) the change in trend GDP per capita *growth* over 1985-2005, rather than the 2005 GDP per capita *level*, is used as an indicator of initial conditions; ii) account is made for the difficulty to undertake reform in certain areas, i.e. when the “corrected” responsiveness rate is used; iii) the number of years in which some legislation is taken rather than the responsiveness rate is used; iv) responsiveness to labour-productivity and labour-utilisation enhancing policies are checked separately for correlation with the initial conditions in the corresponding performance area.

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ANNEX 2.A1

Constructing Qualitative Indicators of Reform Action

Two alternative summary indicators of reforms are constructed in order to identify reform patterns across the OECD since the inception of *Going for Growth*. A “responsiveness rate” sums up overall reform activity in *Going for Growth* priority areas, while a “follow-through rate” assesses the extent to which commensurate policy action has been taken to address priorities. Both indicators are computed over the period 2005-2009 for each individual priority area, broad reform field (labour-productivity or labour-utilisation enhancing reforms) and individual country.

The “responsiveness rate”

The “responsiveness rate” is calculated based on a scoring system which, for each possible reform opportunity – i.e. whenever there was a priority for the individual policy area considered in the previous edition of *Going for Growth*, assigns value 1 if significant action is taken, and 0 otherwise. The responsiveness rate is therefore calculated as the ratio of the total number of years in which some action towards addressing the policy weakness is taken to the total number of years in which some action could potentially be taken – which by definition excludes the year when the policy priority is first set. For instance, the overall responsiveness rate RR^i of country i is:

$$RR^i = \frac{\sum_p n_p^i}{\sum_p N_p^i}$$

where n_p stands for the number of years in which some action is taken on policy priority p , and N_p is the number of years in which some action could potentially be taken. This overall responsiveness rate can also be expressed as a weighted average of the country’s responsiveness rates RR_p^i in each individual priority area p , with weights reflecting the share of each priority area in the total number of priorities set over 2005-2009:

$$RR^i = \frac{\sum_p RR_p^i N_p^i}{\sum_p N_p^i}$$

Because some policy areas appear to be more difficult to reform than others, the nature of priorities set for any particular country may have an impact on its responsiveness rate. For example, a country with weaknesses mainly in labour market policies might be expected to be less “responsive” to *Going for Growth* recommendations than a country with priorities in easier-to-reform areas such as innovation or public sector efficiency, even under similar

reform appetite in both countries. In order to account for this, a “corrected” responsiveness rate is computed as:

$$RR_{corrected}^i = \frac{\sum_p RR_p^i \left(\frac{\overline{RR}_p^i}{RR_p} \right) N_p^i}{\sum_p N_p^i}$$

Where \overline{RR}_p^i denotes the overall responsiveness rate across all policy areas and countries, and RR_p is the overall responsiveness rate in policy priority area p across countries. The “corrected” responsiveness rate thus weighs responsiveness on each individual priority area RR_p^i according to the difficulty to undertake reform in that field, as measured by the ratio \overline{RR}_p^i / RR_p of the overall responsiveness rate to the responsiveness rate in the priority area p considered (both averaged across countries).¹

The “follow-through rate”

The “follow-through rate” instead focuses on deep reforms by setting a more stringent criterion. Concretely, for each possible reform opportunity, the underlying coding of reform efforts involves assigning value one if any action taken is significant enough to warrant a removal of the corresponding priority in the following *Going for Growth* exercise, and zero otherwise. The follow-through rate is basically the ratio of the number of priorities dropped following significant action during the previous two years to the total number of two-year *Going for Growth* cycles in which the policy recommendation appears. The follow-through rate cannot be readily compared with the responsiveness rate since it is computed over a two-year rather than a one-year period, and only over the period 2005-2008 – rather than 2005-2009 – covered by the 2005, 2007 and 2009 issues.

Caveats

Both the responsiveness rate and the follow-through rate measure the extent to which OECD countries have followed up on *Going for Growth* recommendations since 2005. They should not be interpreted as broad reform intensity indicators, as they do not quantify the magnitude of individual measures taken in priority areas and ignore altogether significant reforms that may be carried out in non-priority areas. Furthermore, these indicators are no substitutes for reform assessments based on OECD structural policy indicators, which form the backbone of *Going for Growth*. Nevertheless, they are used here mainly due to their greater comprehensiveness and timeliness.

The construction of responsiveness and follow-through rates is also subject to a number of practical limitations, implying that these indicators should be read with caution:²

- While the underlying binary scoring system limits the impact of judgment calls in assessing the extent of reform efforts, it also has drawbacks. In particular, the responsiveness rate treats minor legislative actions no differently from sweeping reforms, while the follow-through rate ignores major reforms whenever these are insufficient to fully address the policy recommendation – as may happen for instance when initial policy settings are very inadequate.
- When coding reform efforts, the reform year is considered to be the year in which legislative action is taken, rather than the year in which implementation actually takes place or legislation becomes effective. One implication is that whenever legislative

action is taken with a view to implementing a reform agenda over an extended time period, only the decision year is considered as a reform year in the calculation of the responsiveness rate. This may lead to an understatement of actual reform efforts over a given time period, *ceteris paribus*.

- Because laying the groundwork for undertaking reforms takes time, the year in which a particular policy recommendation was first made is not counted as a reform opportunity in the calculation of responsiveness rates. This approach ultimately presumes that there is no time overlap between the reform agendas of governments and the policy recommendations made in *Going for Growth*. However, it implies that governments are not credited for reforms carried out in the first year when a *Going for Growth* priority is first set in the corresponding area.
- Once they are dropped, even when no significant action has been taken, priority areas are no longer covered by the reform indicators. Insofar as governments are more likely to act on policy priorities some time after they are identified, the indicators may not fully reflect longer term progress in reform.
- Some priorities reappeared in the 2009 *Going for Growth* assessment, after having been identified as a weakness in 2005 and dropped in 2007 even though no significant action had been taken. Such priorities are treated as if they had remained priorities since 2005 – i.e. as if they were priorities in the 2007 and 2008 exercises – and reform scores are computed accordingly. However, reform measures carried out in “missing” years may not always be fully documented in such cases.
- No negative scores are assigned when action taken is in contradiction with the priority, i.e. when it results in a deterioration of the corresponding policy stance. This approach potentially results in an overstatement of reform activity, *ceteris paribus*. For example, if positive legislative action is taken and reversed at a later date, the indicators capture some progress even though policy settings ultimately remain unchanged.

Notes

1. There is in fact no straightforward way to correct for the difficulty to undertake reform, and one drawback of the fairly intuitive formulation retained here is that the “corrected” responsiveness rate can in principle exceed 100%. A 100% bound is imposed in those very few cases where, in practice, this happens.
2. Different but still related policy recommendations may be merged between consecutive *Going for Growth* exercises, or conversely a recommendation may be split into separate, more detailed ones. Although, it is not a practical limitation, *per se*, in those cases, reform indicators are computed as if the merged priorities continued to exist separately after the merger, and as if the split priorities were already separate priorities before the split.

ANNEX 2.A2

*Incorporating Terms-of-Trade Gains and Losses into International Income Comparisons*¹

Substantial changes in the relative prices of internationally traded goods have taken place over the past decade, most notably wide swings in oil and raw material prices and a continuous decline in the price of information and communication technology (ICT) goods. These price changes have inserted a wedge between production and real incomes in countries with relatively strong or weak specialisation in the goods concerned. Improvements in the terms of trade amount to a windfall gain for a country as a whole, and imply an increase in its real income and material well-being even under unchanged output. Put simply, an improvement in the terms of trade means a country gets more for less. This phenomenon is similar in many ways to technological progress. Contrary to the treatment of technological progress, however, a change in the terms of trade is treated by the System of National Accounts as a price phenomenon, rather than a real effect. Consequently, the beneficial effect of an improvement in the terms of trade is not captured by real GDP measures.¹

Previous work by the OECD, reported in particular in *Going for Growth 2006*, evaluated a range of national accounts-based measures of material well-being, including real gross national income, which takes account of terms-of-trade effects and also makes adjustments for net foreign transfers from abroad that in some cases can be quite large (Boarini *et al.*, 2006). This earlier work did not examine real gross domestic income (GDI) at PPP, a measure whose computation has recently gained a clearer methodological foundation, as the index number properties of its deflators relative to those of the standard GDP measure have been more systematically evaluated (Feenstra *et al.*, 2009; Reinsdorf, 2009).

This annex uses newly-derived computations of real GDI to compare income and output across OECD countries and over time. The analysis finds that taking account of the terms of international trade can indeed be important for assessing *both* changes and cross-country differences in real income, and thereby in material well-being. Regarding *changes* in real income, the gap between real GDI and real GDP per capita growth has exceeded one percentage point annually in several OECD countries over the past decade, confirming that terms-of-trade effects can undermine the accuracy of real GDP per capita growth as an indicator of advances in material living standards. Regarding *real income levels*, and given the conventions used in constructing OECD GDP PPPs, the current *Going for Growth* practice of comparing real GDP per capita levels across countries using PPPs comes in fact close – although it is not fully equivalent – to comparing real GDIs per capita, and as such it

already largely incorporates terms-of-trade effects. One option going forward would be to use explicit real GDI per capita measures for benchmarking purposes in the context of *Going for Growth* – regardless of whether other, more radical, changes to performance benchmarks are considered, such as further development of the types of measures discussed in the conclusions to the recent report of the Commission on the Measurement of Economic Performance and Social Progress (see Box 2.1 in Chapter 2).

From output (real GDP) to income (real GDI)

A number of OECD countries have experienced strong trend changes in their terms of trade over the past decade. For instance, Australia has benefited from a strong improvement in its terms of trade as a result of large increases in commodity prices, while Finland has experienced a terms-of-trade decline as a result of rapid falls in the price of its ICT good exports. Such large shifts in the prices of exports relative to those of imports drive a wedge between the value of production and real incomes, and can offset some of income gains from productivity growth when the latter is concentrated in goods and services that suffer relative price declines on world markets, such as ICT goods. Given that the broadening of globalisation has favoured greater degrees of specialisation, especially for relatively small countries, taking into account gains and losses from the terms of trade is of growing relevance.

In recent years, some effort has been made in the measurement literature to examine the evolution of real GDI and incorporate the terms of trade effects into income computations for certain OECD countries, such as Canada, Switzerland and the United States, among others (see Kohli, 2004, 2006; Reinsdorf, 2009). The main implication is that if the objective is to compare relative incomes across countries and changes over time, then real GDI should be preferred to real GDP, though for productivity measurement the focus should continue to be on real GDP.

The distinction between real GDP and real GDI is made in the UN System of National Accounts, though there is no conceptual difference between *nominal* GDP and GDI.² However, *real* GDP and GDI can differ because their deflators are different. More precisely, the latter may be defined as:³

$$\text{Real GDI} = (\text{Nominal GDP}) / (\text{Domestic absorption price index})$$

where domestic absorption equals consumption plus investment and government expenditure (C + I + G), or equivalently GDP minus the trade balance, the latter being defined as exports minus imports (X - M). In comparison, the traditional output-based concept defines:

$$\text{Real GDP} = (\text{Nominal GDP}) / (\text{GDP price index})$$

and thus, the difference in the concepts is only on account of the difference in their deflators:

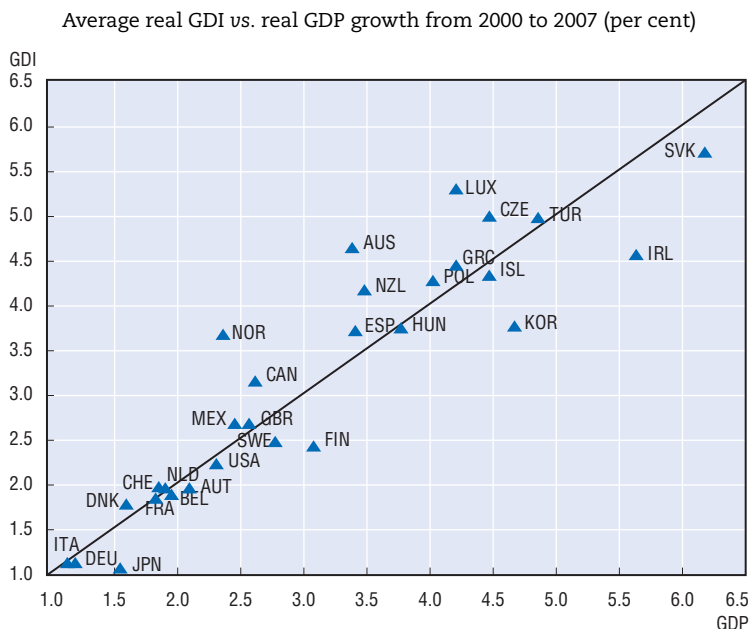
$$\text{Real GDI} - \text{Real GDP} = \frac{X - M}{P_{da}} - \left(\frac{X}{P_x} - \frac{M}{P_m} \right)$$

where P_{da} is the price index for domestic absorption and P_x and P_m are the price indexes for exports and imports, respectively. Thus, computing real GDP in domestic currency amounts to deflating each component of GDP by corresponding deflators (*i.e.* the export and import price deflator for exports and imports, respectively), while computing real GDI implies deflating the whole trade balance by the price index for domestic absorption.


Real GDI affects the evolution of income measures over time

Over the past decade, real income growth has varied substantially for some countries according to whether it is measured by the evolution of real GDI or by changes in real GDP. Depending on the composition of trade, and focusing on the period 2000-2007, countries can be separated into those that gained and those that lost in effective terms as a result of shifts in their terms of trade (Figure 2.A2.1). Annual real GDI growth exceeded real GDP growth by over one percentage point in Australia and Norway as a result of favourable shifts in commodity prices over the period. Canada and New Zealand also benefited, albeit to a lesser extent. Other countries that enjoyed sizable terms-of-trade gains include the Czech Republic, Luxembourg and Spain. By contrast, Ireland, and to a lesser extent Finland, Japan, the Slovak Republic and Sweden suffered significant terms-of-trade losses over the 2000 to 2007 period.

Figure 2.A2.1. **Real income growth differs noticeably from real GDP growth in a number of OECD countries**



Source: OECD National Accounts Database.

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Just like focusing on real GDI *growth* can yield a different income growth picture than looking at real GDP growth, focusing on real GDI *levels* can significantly alter cross-country differences in income levels compared with comparisons based on real GDP levels. In order to make comparisons of income levels across countries, domestic currency values need to be converted using appropriate purchasing power parities (PPPs). Own-currency GDP is usually deflated for international comparison using the GDP PPP, while own-currency GDI should be deflated using the PPP for domestic absorption only, analogous to the use of the domestic absorption price index for deflation over time (see Feenstra *et al.*, 2009). These concepts in level terms can be defined as follows:

$$\text{Real GDP at PPP} = (\text{Nominal GDP}) / (\text{PPP for output})$$

$$\text{Real GDI at PPP} = (\text{Nominal GDP}) / (\text{PPP for domestic absorption})$$

The deflation procedure that is used for converting GDP in a country's own currency to international dollars at PPP, in use by the OECD and other international organisations, is actually closer in practice to GDI than to an output-based concept. This means that it is actually straightforward to compute purely GDI-based PPPs. And because published GDPs at PPP already capture some terms-of-trade effects, they are fairly appropriate for international comparisons of income levels, but raise some issues for output and productivity level comparisons (see Box 2.A2.1). GDI-based PPPs for the 2005 benchmark year may then be used in combination with inter-temporal GDI deflators (using domestic absorption) over time to compute a real income (real GDI) measure that is comparable both over time and across countries.

Box 2.A2.1. The difference between the “true” real GDP and real GDI in levels at PPP

The distinction between the income (GDI-based) and the output (GDP-based) deflator concepts implies that changes in the terms of trade will affect the growth rates of GDI and GDP differently. However even the relative levels between countries differ according to which concept is used, because the PPP is not the same for domestic absorption and for overall GDP. In order to correctly measure the terms-of-trade effect in levels across countries and therefore to make accurate international comparisons of output, reliable PPPs for both imports and exports are needed. Experimental work has been carried out using import and export unit value ratios for traded goods to derive PPPs, which attempt to control for major differences in the composition of trade (Feenstra *et al.*, 2009).¹ Using this rough approximation, it appears that cross-country differences in output levels can vary dramatically from cross-country gaps in incomes. This can be observed by examining the difference between the concepts:

$$\text{GDI}_{\text{GDI PPP}} - \text{GDP}_{\text{Output PPP}} \approx \left(\frac{\text{PPP}_x}{\text{PPP}_{da}} - 1 \right) \left(\frac{X}{\text{PPP}_x} \right) - \left(\frac{\text{PPP}_m}{\text{PPP}_{da}} - 1 \right) \left(\frac{M}{\text{PPP}_m} \right) \quad (1)$$

where PPP_x and PPP_m are the purchasing power parities for exports (X) and imports (M), respectively.

In fact, Feenstra *et al.* (2009) estimate that the differences between the income (GDI) and output (GDP-based) concepts can be very large in levels. Taking extremes, in 1996, real GDI at international prices – which is not far from the real GDP at PPP as currently measured and used for benchmarking purposes in *Going for Growth* (see below) – exceeded real output by more than 15% in Ireland, Mexico and Switzerland, while real output was over 15% higher than real GDI in Iceland and Norway. In order to correctly assess labour productivity gaps across countries, separate from terms-of-trade effects, this output-based concept should be computed.

What is the current practice at the OECD? The recommendation by the Eurostat-OECD PPP Manual is to use the “Standard” GDP PPP to compute the level of GDP per capita for a comparison year. In applying this GDP PPP measure to GDP, because PPPs for exports and imports are difficult to measure, they are approximated by the market exchange rate, implicitly assuming the law of one price holds for tradables. By making this approximation – and using the same deflator for both imports and exports, the “Standard” GDP PPP in fact to a large extent takes into account, for that given year, the level of the terms-of-trade effect. As a result, the “Standard” GDP PPP comes closer in practice to a GDI at PPP than to

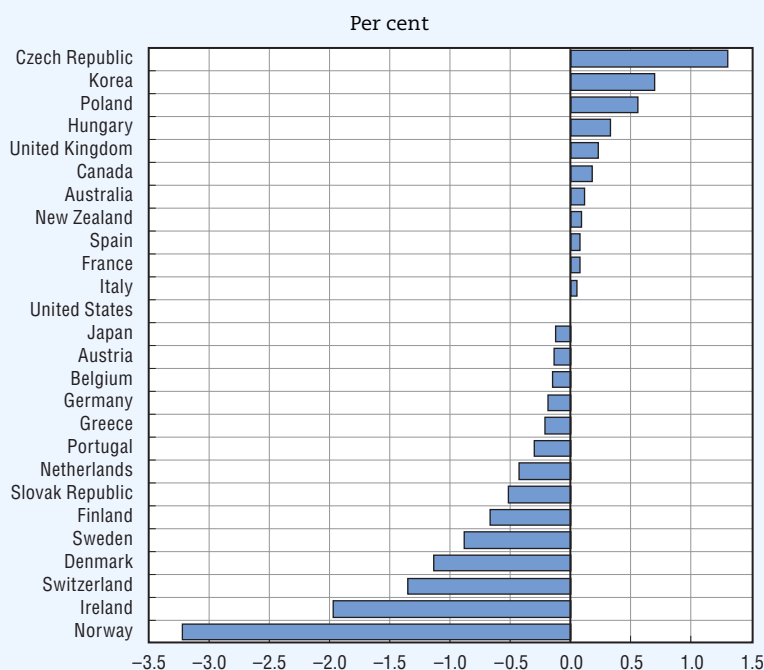
Box 2.A2.1. The difference between the “true” real GDP and real GDI in levels at PPP (cont.)

an output measure at PPP. This can be observed by replacing PPP_x and PPP_m in equation (1) with the exchange rate, $exch$, to obtain:

$$GDI_{GDI\ PPP} - GDP_{\text{“Standard”}\ GDP\ PPP} = \left(\frac{exch}{PPP_{da}} - 1 \right) \left(\frac{X - M}{exch} \right) \quad (1')$$


In the case of balanced trade, the OECD’s GDP at “Standard” GDP PPP measure is in fact equal to the above GDI at PPP measure. In the case of *unbalanced* trade, while it would be conceptually preferable to use the domestic absorption PPP to compute GDI at PPP, the difference between the “Standard” measure that is current employed by the OECD and an ideal GDI PPP measure is in fact relatively small, as shown in the figure below for the benchmark year 2005.

Difference between real GDI at PPP and “Standard” real GDP at PPP in 2005



Note: Real GDI is obtained using the PPP for domestic absorption, while real GDP uses the OECD’s “Standard” GDP PPP.

Source: Calculated from the OECD National Accounts Database.

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Despite the conceptual similarity (particularly as compared to an “ideal” output-based PPP concept) between the GDI at PPP and the OECD’s “Standard” GDP PPP, the differences are not negligible, ranging from negative 4.2% of GDP for Ireland to positive 2.5% for Australia. For this reason, Figure 2.A2.1 in this annex uses purely GDI-based PPPs rather than the OECD’s “Standard” GDP PPPs.

1. These estimates rely on unit values for traded goods at the four-digit SITC level to determine their relative price parities for the construction of import and export PPPs. They implicitly assume that there are no quality differences among traded goods at this level. This is a very strong assumption, and the treatment differs from that in much of the intra-industry trade literature, where international differences in unit values are seen as evidence of quality differences. While there has been work to separate quality from price by Hallak and Schott (2008), which suggests that quality differences may be less of an issue for OECD countries, this analysis remains highly experimental. Thus, these estimates of the difference between real GDI at GDI PPPs and real GDP at output-based PPPs should be considered as indicative of the overall scale of the measurement problem rather than as point estimates in themselves.

Do terms-of-trade issues have implications for *Going for Growth's* assessments and policy recommendations?

Much of the empirical work that underlies *Going for Growth* policy recommendations relies upon GDP-based national accounts aggregates as their explanatory variables. In particular, dynamic panel regressions have been estimated that explore the policy and institutional drivers of either labour productivity growth (GDP per capita or GDP per worker) or GDP-based total factor productivity growth. While these measures avoid the problems discussed above with the level of GDP at PPP, since they rely on growth rates, they do not take into account terms-of-trade gains and losses.

Whether ignoring terms-of-trade changes affects the policy recommendations derived from previous OECD empirical studies is unclear *a priori*. Insofar as terms-of-trade changes are distributed randomly across countries, or at least are unrelated to the structural policies which have been identified as significant influences on productivity growth, policy conclusions drawn from previous OECD work are unaffected. This is no longer the case, by contrast, if certain structural policies have side effects on terms of trade and income which have been overlooked thus far. Unfortunately, it is difficult to discriminate between these two possibilities in practice, due to lack of empirical evidence on the export and import price effects of structural policy reforms.

One open question is whether the productivity-enhancing effects of reforms may have been partly offset – in terms of their impact on incomes – by terms-of-trade declines in some OECD countries since the mid-1990s. In a few small open economies for instance (*e.g.* Finland), structural reforms have been concomitant with increased specialisation in information and communication technology goods, whose relative price has steadily declined. This decline has dampened the effectiveness of productivity gains in boosting material living standards. By contrast, any side-effects of reforms on income through the terms-of-trade channel are likely to be small in larger, more diversified economies.

Notes

1. This issue is elaborated in Diewert and Morrison (1986) and Kohli (2004, 2006). While the balance of imports and exports is of course a vital part of standard GDP computations, the deflators used to evaluate this item in real terms for comparisons across both time and space (countries) make certain assumptions that have conceptually weak foundations.
2. This is leaving aside the statistical discrepancy that may exist in practice between income and production approaches to compiling national accounts.
3. There is no uniform official definition of real GDI, as various deflators can be used to discount imports and exports. However, there are solid theoretical reasons to use the domestic absorption price index to deflate both import and export values (see Kohli, 2004)

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