PART I

Taking Stock of Structural Policies in OECD Countries

ECONOMIC POLICY REFORMS: GOING FOR GROWTH – ISBN 92-64-03047-6 – © OECD 2007

ISBN 92-64-03047-6
Economic Policy Reforms
Going for Growth

PART I

Chapter 1

Structural Policy Priorities: An Overview

A large number of OECD countries have failed to narrow the gap in GDP per capita vis-à-vis *the leading countries over the past decade, calling for a re-assessment of the main policies having an impact on the key growth drivers. This chapter provides an overview of broad trends in growth performance over the recent past and the policy priorities that have been identified in each country to address specific performance weaknesses. Given that high unemployment and low labour force participation remain a major preoccupation in many continental European countries, measures to improve the labour market performance account for the bulk of policy priorities in these economies. For low-income countries, as well as in Japan and Switzerland, raising productivity is the main challenge and hence priorities tend to focus more on liberalisation of product markets, especially in network industries and services. English-speaking countries have generally good labour market performance, but share in common the need to raise the skills level, in particular via an improvement of secondary education.*

Introduction

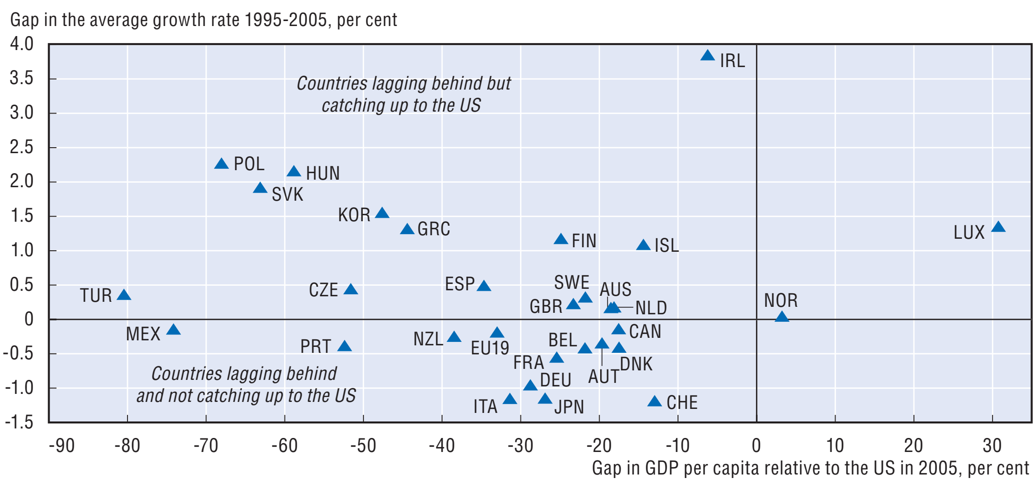
Differences in material living standards across OECD countries reflect in part different structural policy settings. Relatively low income per capita and failure to converge on the highest-income country can therefore be signs of policies not being as growth-friendly as they could be. Successive empirical studies by the OECD have sought to identify the policy levers that influence GDP per capita and its growth. As part of these exercises, indicators have been developed that summarise performance in key components of GDP per capita and the stance of related policies in a consistent way across countries and over time.

As in the 2005 *Going-for-Growth* assessment, this round employs these indicators and studies to identify policy priorities to raise GDP per capita based on international benchmarking of performance and policies. This chapter provides an overview of broad trends in growth performance over the recent past and the policy priorities that have been identified to address specific performance weaknesses. The policy priorities are discussed in greater detail in the country notes in Chapter 2.

Growth performance in OECD countries: Key stylised facts[1]

Only around half of OECD countries have made some progress towards converging on the living standards of the benchmark country (United States) during the past ten years (Figure 1.1).[2] Relatively living standards did improve in Ireland and a few lower-income

Figure 1.1. **GDP per capita levels and growth rates: gap *vis-à-vis* the United States**[1]



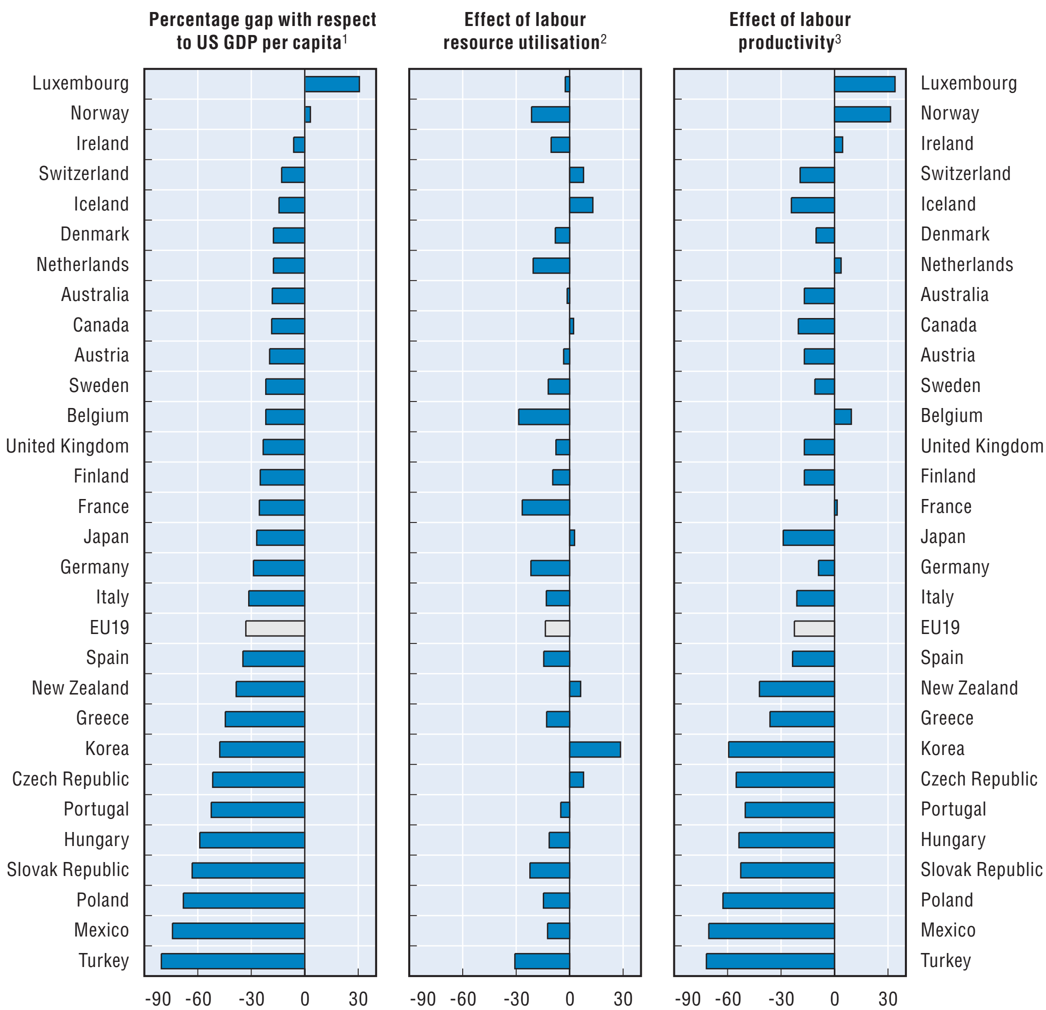
1. The average growth rate of GDP per capita is calculated on the basis of volumes data from national accounts sources. The level of GDP per capita is calculated on the basis of 2005 PPPs. In the case of *Luxembourg*, the population is augmented by the number of cross-border workers in order to take into account their contribution to GDP. Data for *Greece* do not take into account the 25 per cent upwards revision to the level of GDP announced in 2006.

Source: OECD, *National Accounts of OECD Countries*, 2006; and *OECD Economic Outlook*, No. 80.

countries, but the gap remained constant for the two OECD economies with the lowest income level. Material living standards exceed those in the United States only in Luxembourg and Norway.[3]

The gap in GDP per capita *vis-à-vis* the benchmark country can be broken down into contributions from labour productivity and labour utilisation. The GDP gap in several continental European countries relative to the United States is mostly accounted for by low labour utilisation (Figure 1.2). This reflects weak labour-force participation, often combined with short working hours and high unemployment. And, although measured labour productivity is often close to that in the United States in these countries, this is partly due to a compositional effect, the relatively low employment rates of the unskilled workers showing up in comparatively high average output per person employed and per hour

Figure 1.2. **The sources of real income differences, 2005**



1. Based on year 2005 purchasing power parities (PPPs). In the case of *Luxembourg*, the population is augmented by the number of cross-border workers in order to take into account their contribution to GDP. Data for *Greece* do not take into account the 25 per cent upwards revision to the level of GDP announced in 2006.
2. Labour resource utilisation is measured as total number of hours worked divided by population.
3. Labour productivity is measured as GDP per hour worked.

Source: OECD, *National Accounts of OECD Countries*, 2006; *OECD Economic Outlook*, No. 80; and *OECD Employment Outlook*, 2006.

worked. A recent study suggests that measured labour productivity would be as much as 15% lower relative to the United States in some countries if employment rates and average hours worked were the same (Bourlès and Cette, 2005).[4]

In other countries, the labour-productivity gap explains more of the weakness of GDP per capita compared with the benchmark country. Low output per hour worked accounts for more than the whole, or most, of the GDP-per capita gap in Switzerland, Iceland, Korea, Japan and non-US English-speaking countries. Labour productivity is also the main factor behind the shortfall in GDP per capita in low-income economies, although labour utilisation is also typically well below the level in the benchmark country due to low participation and, in some cases, high unemployment. In some of the Nordic countries (Denmark, Finland and Sweden), the labour-productivity gap contributes as much to the lower level of GDP per capita compared with the United States as does lower labour utilisation, with the latter reflecting essentially low average hours worked per worker.

Areas of policy priorities

To address countries' performance weaknesses in terms of labour productivity or utilisation, policy priorities have been selected on the basis of standardised criteria (Box 1.1). The summary of the policy priorities below first covers measures aimed at correcting weaknesses in productivity performance and then those that are intended to improve labour utilisation (Table 1.1). However, it should be kept in mind that a policy reform selected with a view to improve performance in one area may also have beneficial effects in the other area.

Policies to improve labour productivity performance

Labour productivity can be stimulated by policy settings that are conducive to profitable investment in physical capital (including information and communication technologies) and human capital, as well as in research and development. A policy area of particular relevance in this context is product market regulation, such as regulatory barriers to competition in product markets in the form of state control, administrative or legal barriers to firm entry or international trade and foreign direct investment (FDI) (see Chapters 5 and 6). Indeed, given the potential efficiency gains, including stronger innovation activity, from exposing the business sector to intense competitive pressures, these are identified as one of the prime areas of policy priority to boost labour productivity.[5] Another policy area of major relevance for improving productivity performance is related to human capital development.

Product market regulation

Better recognition of the importance of strong competition in product markets for productivity performance has been reflected in moves to ease restrictions in this area in recent years. Under the persistent pressure from internal market completion, further progress has been made in EU countries – especially newer member states from Central Europe – with respect to easing of entry controls and reduction of state control, in particular in major network industries. Furthermore, even though the new Services Directive agreed in early 2006 falls short of initial ambitions, it should provide some additional stimulus to the integration of markets for services. Outside Continental Europe, product market regulations have generally been less stringent and some progress has been made in the recent past, especially with respect to reducing barriers to entry, strengthening competition legislation and easing controls on FDI.

 ECONOMIC POLICY REFORMS: GOING FOR GROWTH – ISBN 92-64-03047-6 – © OECD 2007

Box 1.1. **2007 Going for Growth: purpose and principles**

The purpose of this exercise is to identify, for all individual countries and the European Union, five policy priorities most likely to boost the growth of GDP per capita in the future.* Three of these policy priorities are based on internationally-comparable indicators of performance and policy settings, confirmed by country-specific knowledge. The additional two priorities are not necessarily supported by indicators but draw on country-specific expertise in order to capture important policy areas that cannot always be assessed on the basis of quantitative indicators.

The starting point for the selection of indicator-based policy priorities is a detailed examination of labour utilisation and productivity performances so as to uncover specific areas of relative strengths and weaknesses (see Annex 1.A2 for further details of the methodology). The performance indicators are juxtaposed with a broad set of policy indicators (see Chapter 3), all of which have been shown to have an impact on the relevant aspect of performance, with the aim of identifying cases where performance and policy weaknesses appear to be linked. More specifically, in order to avoid a one-size-fits-all approach to policy reform, a deviation from a growth-friendly practice in a particular policy area is considered a candidate for priority selection only if a weak performance is also identified in an area that is affected by the policy in question. When there are more than three candidates for indicator-based policy priorities, the list is narrowed down by selecting the candidates that will have the strongest effect on GDP per capita according to previous OECD studies.

The current exercise has been broadened to include policies to encourage innovation activity in addition to the policy areas previously covered, *i.e.* essentially labour and product market policies, supplemented by some policy/performance indicators for health and education. The 2006 edition of *Going for Growth* established policy recommendations to strengthen innovation for all OECD countries, and they are incorporated among the overall priorities here to the extent that they are assessed to be a priority to raise economic growth according to the above selection criteria. As discussed in last year's edition, some of the policy levers that directly affect productivity and labour utilisation also have a significant effect on R&D intensity, and thereby on productivity. Where such policies are selected as a priority to pursue productivity goals in general and employment objectives, they will therefore also have beneficial effects via innovation activity.

* The selection of the same number of priorities for all OECD countries has been motivated by the desire to identify policy reforms that help improve everyone's performance, the better-performing economies included, and to ensure a certain degree of equality of treatment across member countries. However, this implies that for less-well performing countries with policy settings deviating from best practices in many areas, important policy priorities will be left out. Conversely, the priorities identified in countries with generally good performance may not always be seen as pressing issues.

Despite broad trends towards privatisation of public enterprises and opening of markets, a significant number of countries still have shortcomings in productivity performance that appear related to strict regulation in some specific sectors. To improve productivity performance, including via stronger innovation activities, it is a priority to boost competition in those sectors that have so far remained largely sheltered. More specifically:

- Regulatory barriers to competition in network industries should be lowered in Australia, Austria, Canada, France, Germany, Greece, Ireland, Korea, Mexico, Netherlands, Poland, Portugal and Switzerland. This is particularly pressing in the energy sector (gas and electricity) and, to a lesser extent, transport and communications (telecoms and posts).

Table 1.1. **Structural policies and performance: proposed priorities**[1]

	Performance areas	
	Labour utilisation	Labour productivity
Australia	Continue reform of disability benefit schemes to encourage work by existing claimants with substantial work capacity. Strengthen employment prospects of lower-skilled workers by improving vocational education. *Phase out the current wage-setting system (award wages) to allow greater flexibility in wage bargaining.* *Further reduce effective marginal tax rates on low-income workers to encourage full-time work.*	Promote competition in network industries by encouraging greater regulatory consistency and market integration across states.
Austria	Reduce disincentives to work at older ages by limiting early retirement through unemployment benefits. *Strengthen incentives to work by reducing marginal taxes on labour income.*	Improve quality and efficiency of tertiary education by strengthening performance-based funding. Promote competition in network industries by reducing ownership restrictions and other barriers to entry. *Promote competition in services by reducing statutory regulation of trades and professions and abolishing compulsory chamber membership.*
Belgium	Reduce tax wedge on low-income workers to increase employment opportunities for this group. Reduce disincentives to work at older ages by reforming early retirement pathways. *Strengthen enforcement of job search requirement by ensuring better coordination between placement agencies.* *Reduce geographical mismatches in labour markets by increasing the scope for individual firms to opt out of nation-wide sectoral wage agreements.*	Promote competition in retail distribution by further easing regulation on zoning and opening hours.
Canada	*Reduce inefficiency of the employment insurance system to allow for lower contributions.* Further reduce barriers to foreign direct investment to facilitate transfers of new technologies and management practices from abroad.	Promote competition in electricity markets by encouraging greater liberalisation and integration across provinces. Promote competition in professional services by reducing the number of regulated occupations and other obstacles to inter-provincial trade. *Further reduce taxation of firms' ownership of capital and harmonise effective tax rates across businesses to encourage private investment.*
Czech Republic	Stimulate hiring by cutting the costs of EPL for regular workers. Reduce the tax wedge on low-income workers to increase employment opportunities for this group.	Reduce administrative costs for start-ups to stimulate product market competition. *Raise public-sector efficiency by reforming the health care system and strengthening financial incentives for mergers at the municipal level.* *Raise funding for tertiary education by introducing a fee system backed by income-contingent student loans.*
Denmark	Cut disincentives to work longer hours by reducing marginal taxes on labour income. Refocus sickness and disability benefit schemes to encourage work by those with substantial work capacity. *Reduce housing subsidies and abolish rent regulation to minimise housing market distortion and facilitate labour mobility.*	Improve educational achievements to raise efficiency of the labour force. *Ease regulatory burden on business operations to stimulate product market competition.*
Finland	Strengthen work incentives by further reducing the tax wedge on labour income. Reduce implicit tax on continued work at older ages by reforming early retirement pathways. Reduce the incidence of long-term unemployment by tapering unemployment benefits with duration. *Promote greater flexibility in centralised wage agreements to expand employment opportunities.*	*Reduce the scale of public ownership to facilitate entry and stimulate product market competition.*

Table 1.1. **Structural policies and performance: proposed priorities**[1] *(cont.)*

	Performance areas	
	Labour utilisation	Labour productivity
France	Reduce the duality of the labour market by cutting the costs of EPL regulation for regular workers. Stimulate labour demand for youth and low-skilled by allowing for a relative decline in the minimum cost of labour. *Reduce implicit tax on continued work at older ages by reforming early retirement pathways.*	Promote competition in retail distribution and network industries by reviewing regulation concerning access conditions and pricing practices. *Improve quality and efficiency of tertiary education by introducing a fee system backed by income-contingent student loans.*
Germany	Strengthen work incentives by reducing the tax wedge on labour income. *Reduce disincentives to full-time female labour force participation by improving access to child-care facilities and lowering taxes for second earners.* *Strengthen incentives to move from welfare to work via more effective job placement and stricter conditionality.*	Raise overall human capital by improving efficiency of the education system. Promote competition in professional services and network industries by reducing regulatory barriers to entry.
Greece	Stimulate hiring of white-collar workers by reducing the cost of EPL for this group. Reduce disincentives to work at older ages by linking benefits to lifetime contributions. *Stimulate labour demand for youth by introducing a sub- minimum wage for young people.*	Promote competition in network industries by reducing ownership restrictions and other barriers to entry. *Improve quality and efficiency of tertiary education by strengthening performance-based funding.*
Hungary	Strengthen work incentives by reducing the tax wedge on labour income. Continue reform of disability benefit schemes to encourage work by those with substantial work capacity. *Reform tax and benefit systems to stimulate employment in the formal sector.*	Raise overall human capital by improving efficiency of the education system. *Raise public-spending efficiency by accelerating reform of public administration and by addressing weaknesses in budget planning.*
Iceland	*Reduce government backing of bonds issued by the Housing Finance Fund to reduce housing market distortions and facilitate labour mobility.*	Promote competition in the fisheries and energy sectors by reducing ownership barriers to domestic and foreign entry. Reduce producer support to agriculture, especially the most trade-distorting types. Improve graduation rates from upper-secondary education to raise efficiency of the labour force. *Raise public-sector efficiency by accelerating reform of public administration.*
Ireland	Strengthen work incentives for second earners and lone parents by improving access to child-care facilities.	Promote competition in network industries by facilitating entry and access to network components. Raise overall human capital by improving funding and efficiency of the education system. *Improve governance efficiency of research institutions to strengthen innovation outcomes.* *Improve public infrastructure in a cost-efficient fashion to reduce bottlenecks.*
Italy	Strengthen work incentives by reducing the tax wedge on labour income. *Promote greater flexibility in wage bargaining by decentralising wage setting arrangements in the public sector.*	Promote greater competition for services by fully implementing recent reforms as well as the planned reforms of local government services. Improve quality and efficiency of tertiary education by reviewing the funding and governance of universities. *Improve corporate governance by implementing reforms of financial market supervision and bankruptcy procedures.*
Japan	Reduce the duality of the labour market by cutting the costs of EPL for regular workers.	Promote greater competition in retail and professional services by facilitating entry. Reduce producer support to agriculture, especially the most trade-distorting types. *Encourage innovation by improving access to venture capital and upgrading the education system.* *Reduce barriers to foreign direct investment to enhance transfers of new technologies and management practices from abroad.*

Table 1.1. **Structural policies and performance: proposed priorities**[1] *(cont.)*

	Performance areas	
	Labour utilisation	Labour productivity
Korea	*Strengthen labour force participation for women by improving access to child-care facilities.*	Promote competition in the energy sector by reducing regulatory barriers to domestic and foreign entry. Reduce producer support to agriculture, especially the most trade-distorting types. Reduce administrative costs for start-ups to stimulate product market competition. *Improve the innovation system by strengthening intellectual property rights and industry-science linkages.*
Luxembourg	Reduce disincentives to work at older ages by linking benefits to lifetime contributions more closely. Strengthen incentives to move from welfare to work by tightening entitlement conditions to benefits. *Reduce the duality in the labour market by cutting the costs of EPL for regular workers.*	Improve educational achievement, in particular among ethnic minorities, to raise efficiency of the labour force. *Promote competition in professional services by easing conduct regulation and licensing requirements.*
Mexico	*Shift burden of taxation towards consumption by broadening the value-added tax base.*	Improve education attainment and achievement at the compulsory level to raise efficiency of the labour force. Promote competition in industries by reducing ownership restrictions and other barriers to entry. Reduce barriers to foreign ownership to enhance technological transfers from abroad. *Strengthen investors confidence by improving the enforceability of contracts.*
Netherlands	Strengthen incentives to full-time labour force participation for low-income second earners by reducing their effective marginal tax rates. Continue reform of disability benefit schemes to encourage work by those with substantial work capacity. *Stimulate labour mobility by reforming residential zoning restrictions.*	Promote competition in network industries by facilitating entry and third-party access to network components. *Promote competition in retail services by easing restrictions on large-format stores.*
New Zealand	Strengthen incentives to full-time labour force participation for women by improving access to child-care facilities. *Raise public-sector efficiency through well-designed performance targets in health and education.*	Stimulate investment in the electricity sector by reducing regulatory uncertainties. Improve educational achievement, in particular among ethnic minorities, to raise efficiency of the labour force. *Improve the road-pricing system to reduce transport bottlenecks.*
Norway	Refocus sickness and disability benefit schemes to encourage work by those with substantial work capacity. Implement the proposed pension reform to raise incentives to remain in the labour force at older ages. *Reduce disincentives to work at older ages by raising actuarial neutrality of the pension system.*	Reduce producer support to agriculture, especially the most trade-distorting types. Reduce the scope of public ownership in financial services and network industries to stimulate foreign investment and competition.
Poland	Strengthen incentives to work by reducing tax wedges and tightening unemployment support conditionality. *Increase labour mobility by improving transport and housing infrastructures.*	Reduce state control in various sectors to stimulate private investment and effective competition. Improve quality and efficiency of tertiary education by introducing a fee system backed by income-contingent student loans. *Promote competition in professional services and telecommunications by simplifying regulation and facilitating third-party access.*
Portugal	Reduce labour market segmentation and facilitate labour mobility by cutting the costs of EPL.	Improve education attainment and achievement at the compulsory level to raise efficiency of the labour force. Promote competition in network industries and services by reducing regulatory barriers to entry. *Raise public-sector efficiency by accelerating reform of public administration.* *Stimulate private investment by simplifying the corporate tax system and reducing compliance costs.*

ECONOMIC POLICY REFORMS: GOING FOR GROWTH – ISBN 92-64-03047-6 – © OECD 2007

Table 1.1. **Structural policies and performance: proposed priorities**[1] *(cont.)*

	Performance areas	
	Labour utilisation	Labour productivity
Slovak Republic	Reduce tax wedge on low-income workers to increase employment opportunities for this group. Reduce disincentives to work at older ages by linking lifetime contributions to benefits more closely. *Reform housing markets to reduce distortions and facilitate labour mobility.*	Raise overall human capital by improving efficiency of the education system. *Strengthen the development of market-based activities in the formal sector by improving the enforceability of law and contracts.*
Spain	Promote greater flexibility in wage determination by limiting the extent of administrative extension of collective agreements. Reduce labour-market duality by cutting the costs of EPL for regular workers. *Reduce disincentives to work at older ages by linking benefits to lifetime contributions more closely.*	Promote competition in retail distribution by reducing regulatory barriers to entry. *Improve quality and efficiency of tertiary education by granting universities more autonomy.*
Sweden	Refocus sickness and disability benefit schemes to encourage work by those with substantial work capacity. Strengthen incentives to work longer hours by reducing marginal taxes on labour income. *Reform housing policies to reduce distortions and facilitate labour mobility.*	Reduce the costs of EPL regulation to facilitate human resource management and stimulate innovation. *Improve quality and efficiency of tertiary education by raising incentives for students to start and complete university programme more rapidly.*
Switzerland	Strengthen incentives to full-time labour force participation for women by improving access to child-care facilities. *Promote competition in the provision of medical products and services to contain increases in health care costs.*	Promote competition in network industries by reducing regulatory barriers to entry. Reduce producer support to agriculture, especially the most trade-distorting types. *Review technical regulations related to traded products to stimulate cross-border trade and competition.*
Turkey	Stimulate employment in the formal sector for youth and low-skilled by allowing for a relative decline in the minimum cost of labour. Stimulate hiring of regular workers in the formal sector and facilitate labour mobility by cutting the costs of EPL. *Reduce disincentives to work at older ages by gradually making the pension system actuarially neutral.*	Improve education achievement at the upper-secondary level to raise efficiency of the labour force. *Reduce administrative costs for start-ups to stimulate product market competition.*
United Kingdom	Strengthen employment prospects of lower-skilled workers by improving vocational education. Further reform invalidity pension schemes to encourage work by those with substantial work capacity. *Strengthen incentives to full-time labour force participation for lone parents and second earners by improving access to child-care facilities.*	Improve public infrastructure, especially for transport to further reduce bottlenecks. *Raise public-sector efficiency by strengthening incentives to pursue performance targets in publicly-funded services.*
United States	Limit increases in labour costs by reforming Medicare to restrain health care costs. *Shift burden of taxation towards consumption and broaden the tax base.* *Refocus disability benefit schemes to encourage work by those with substantial work capacity.*	Improve education achievement at the secondary level to raise efficiency of the labour force. Reduce producer support to agriculture, especially the most trade-distorting type.
European Union	*Improve intra-EU labour mobility by enhancing portability of pension and other benefit entitlements.*	Ease internal regulatory obstacles to cross-border trade and entry to reduce compliance costs for businesses. Promote greater competition in product market by further reducing barriers to market contestability in network industries. Reduce producer support to agriculture, especially the most trade-distorting type. *Enhance competition in financial services by ensuring full implementation of the Financial Services Action Plan.*

1. Priorities in italics are not necessarily based on indicators.

Measures to strengthen competition in these industries include reducing ownership restrictions and other barriers to entry, and facilitating third-party access to the network component.

- Regulatory barriers to competition should also be lowered in professional services and/or retail trade in Austria, Belgium, Canada, France, Germany, Japan, Luxembourg, Netherlands, Poland and Spain.
- Efforts to reduce the complexity or opacity of rules and procedures to obtain licenses and/or the administrative burden on start-ups need to be pursued in the Czech Republic, Denmark, Korea and Turkey.
- Easing state control of business operation in various sectors, either via a reduction in direct ownership or a phasing-out of price controls remains a priority in Finland, Iceland, Italy, Mexico, Norway and Poland.
- Restrictions on foreign ownership should be further reduced in Canada, Iceland, Japan, Korea and Mexico.

Markets for agricultural products remain highly distorted in most OECD countries, resulting in misallocation of resources at the domestic level and limiting growth opportunities in the non-OECD area. Although measures have been taken to shift the composition of support towards less trade-distorting forms, significant reforms in this area have been on hold in recent years, pending the outcome of the WTO Doha round. After being officially suspended in July 2006, tentative discussions to re-start trade negotiations have been ongoing during the first weeks of 2007. It is important that multilateral negotiations are successful in bringing significant reductions in current distortions. Reform of agricultural support is identified as a priority for the European Union, as well as for Iceland, Japan, Korea, Norway, Switzerland and the United States. Such reforms should aim both at reducing the overall level of subsidies, and at diminishing the distortionary impact of a given support level by further de-linking it from production.

Human capital

The accumulation of skills and competencies through high-quality education systems has long been recognised as a fundamental driver of growth, not least via its impact on the creation and diffusion of new technologies. However, while both quantity and quality of output from the education system are important, there is still insufficient understanding of the policy settings that contribute to good outcomes in these areas. In absence of direct policy indicators with clear links to outcomes and unlike the practice applied for identifying priorities in other areas, priorities for education reforms are selected on the basis of relative country outcomes such as educational attainments (graduation rates) at the compulsory and tertiary levels and the proficiency of 15-year-olds in specific fields (PISA scores).

Although reforms have taken place in recent years, including changes in the curricula, the establishment of nation-wide educational standards and improvements in access to vocational education, strengthening human capital remains an important area of policy priorities in many countries:

- At the primary or pre-school level, the focus should be on increasing the educational content for school entrants (Denmark) and raising the coverage of early childhood education (Germany, Ireland, Slovak Republic, Turkey and the United States).

- At the secondary level, priorities include reducing the number of early school leavers by strengthening vocational education, raising support for disadvantaged groups and/or curriculum development (Australia, Hungary, Iceland, Ireland, Luxembourg, New Zealand, Slovak Republic and the United Kingdom); and enhancing the standards of education by increasing autonomy and accountability of schools (Germany, Slovak Republic, Turkey and the United States) and by raising the share of non-wage spending combined with modernising curricula (Mexico and Portugal).
- At the tertiary level, an increase in graduation rates remain a common objective, with specific policy prescriptions including raising the level of funding – not least via student fees – and/or granting universities more autonomy in the management of human resources and programmes (Austria, Czech Republic, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Poland, Portugal, Slovak Republic, Spain and Sweden).

Other policy areas

A number of priorities aimed at improving overall economic efficiency concern specific areas that are not covered by indicators. For instance, several countries could raise the cost-efficiency of public services delivery with a reform of public administration (Czech Republic, Hungary, Iceland, New Zealand, Portugal and the United Kingdom), while reforming the tax system is a priority in Canada, Mexico, Portugal and the United States. Also, infrastructure bottlenecks, especially related to transport, require specific policy attention in Ireland, New Zealand, Poland, and the United Kingdom. Moreover, specific measures to strengthen the efficiency of the innovation system, including greater competition for public funds for innovation purposes are recommended for a few countries (Ireland, Japan and Korea). Finally reform of the housing market is a priority in Denmark, Iceland, Netherlands, Slovak Republic and Sweden, with the aim of *inter alia* reducing excessive investment in residential structures but also to improve labour mobility.

Policies to improve labour resource utilisation

Given the relative under-utilisation of labour resources in some Continental European countries, policy priorities to raise participation and employment rates, as well as average hours worked, are more concentrated on these countries. These policies can be organised into three broad categories: taxation; benefits and income support programmes; and labour market regulation.[6]

Average and marginal taxation on labour income

Given the potentially adverse effect of high tax wedges on employment and on efficiency, including via their influence on the size of the shadow economy, several countries have reduced average or marginal tax wedges on labour income over the past two years. However, further reductions are still judged to be a priority to raise labour utilisation in most of these countries, and a number of others have yet to start the process to reduce taxes on labour income:

- In many cases, reforms should aim at lowering tax wedges in general, or employer social security contributions in particular, in order to boost participation rates and/or job creation (Belgium, Czech Republic, Finland, Germany, Hungary, Italy, Poland and the Slovak Republic).
- In other cases, the emphasis should be cutting marginal tax rates so as to stimulate hours worked (Australia, Austria, Denmark and Sweden).

Policy priorities in this area are accompanied by supplementary recommendations on how to finance lower taxes. Thus, it is recommended to cut elements of public spending (Belgium, Czech Republic, Hungary and the Netherlands), reduce tax expenditures (Austria, Germany and Italy) and shift the tax burden to other areas (Austria, Denmark, Finland, Slovak Republic and Sweden). Restraining spending on health and social benefits is specifically recommended for Germany. Indeed, given already high health care costs and associated high non-wage labour costs, achieving efficiency gains in the provision of health care is an important objective in Switzerland and the United States.

Social benefits

Notwithstanding some reforms in recent years, the design of pension and other income-support systems contributes to low participation rates among older workers in many countries. As measured by the implicit tax on continued work,[7] the extent of the disincentive was very high in some countries in 2005, in particular for workers in their late 50s and early 60s. As a result of such employment-adverse policy-settings, corrective measures are a priority for several countries. More specifically, pension schemes should be made more actuarially neutral so as to increase the net financial benefit for older employees of working additional years (Greece, Luxembourg, Norway, Slovak Republic, Spain and Turkey) and alternative routes to early retirement should be reformed with a view to tightening eligibility conditions and eliminating the disincentives to remain in the labour force (Austria, Belgium, Finland and France).

In many countries, the tightening of other early exit routes from the labour market has coincided with a sharp and steady increase in the number of disability benefit recipients, especially among older workers. In Australia, Denmark, Hungary, Netherlands, Norway, Sweden, United Kingdom and the United States, the share of the working-age population receiving benefits, which was already high in the late 1990s, has continued to rise during the first half of the current decade.[8] This has occurred even if most of the countries introduced some measures to stem the flow of new entrants into the programmes via a tightening of controls, greater use of temporary entitlements and by providing job-search assistance to those with residual work capacity.Accordingly, reform of disability benefit programmes is seen as a priority in these countries, and in some of them this should be accompanied by reforms of the sickness benefit system.

High levels of income support to unemployed workers reduce incentives to search for new work, especially when such benefits are accessible for a long period with relatively few conditions. Reforms in this area over the past couple of years have generally focused on strengthening activation measures, including a tightening of eligibility and work-availability conditions and increasing the emphasis on job-search assistance, and, in some cases, the introduction of "in-work" benefits. Unemployment benefit reforms are regarded as being a priority for a few countries. Thus, in Belgium, Germany, Luxembourg and Poland, entitlement conditions for continued receipt of unemployment benefits after a long spell of joblessness should be tightened along with an improvement in the effectiveness of job-search assistance and other activation measures; and, in Finland, benefits should be reduced with the length of the unemployment spell. Also, the income support system should be reviewed in Canada, with a view to limiting the scope for firms engaged in seasonal and temporary activities to benefit unduly from the system.

 ECONOMIC POLICY REFORMS: GOING FOR GROWTH – ISBN 92-64-03047-6 – © OECD 2007

In a similar vein, the full-time participation of women in the labour force can also be hampered by high implicit tax rates on joining the labour force or extending hours worked, especially when costs for child-care are taken into account. In order to make work pay for women with children and with relatively low earning potential, tax disincentives to full-time participation should be lowered and/or access to affordable child-care facilities should be improved in Germany, Ireland, Korea, Netherlands, New Zealand, Switzerland and the United Kingdom.

Labour market regulation and collective wage agreements

Strict job protection regulation reduces the dynamism of the labour market, with adverse effects on the employment prospects of certain groups and on productivity performance. Reform strategies in this area have generally involved the easing of regulations on temporary contracts but no relaxation for permanent contracts, and the exclusion of certain groups from specific provision of the law (Box 1.2). While this may have raised employment in the short run, it has increased the duality of the labour market, with potential negative effects on efficiency

Box 1.2. **Beyond the EPL indicator – The size threshold for protection**

The 2006 up-date of the indicator of employment protection legislation (EPL) shows no change relative to 2003 in most countries, suggesting an absence of reforms over the period. However, changes in EPL made in a few countries, such as Australia, France, Germany and Sweden, are not captured by the OECD indicator. The main reason is that while the indicator is based on the extent of protection for a "typical" worker, reforms made in recent years have often taken the form of new clauses targeted at specific groups of workers, in particular those employed in small firms. Such size-based exclusion has a longer history in some other OECD countries. The table below shows the types of regulations and the share of private-sector employees exempted due to the small size of their workplaces for the countries where this type of information was available.

Exemption from certain types of EPL protection related to the size of workplace

	Types of protection concerned	Share of private-sector employees affected (%)
Australia	Unfair dismissal: the Workplace Relations Amendment Act of 2005 introduced a workplace threshold of 100 for protection for incorporated enterprises and excluded unincorporated enterprises under the federal system.	34
France	Trial period: the CNE ("*contrat nouvelles embauches*"), introduced in 2005, extended the trial period for workers in firms with less than 20 employees to two years. During these two years, employees hired under the CNE can still enjoy a considerable degree of protection.	29
Germany	Unfair dismissal: the workplace threshold for protection was raised from 5 workers to 10 in 2004.	19
Italy	Reinstatement and compensation: firms with fewer than 60 employees (or establishments with less than 15) can convert their reinstatement obligation into compensation equal to 15 months' wages. There is also a two-tiered compensation rate based on the same threshold.	33
Korea	Labour Code: most parts apply from 5 permanent employees.	20
Portugal	Unfair dismissal and notification procedures: micro-enterprises with up to 9 workers are not required to implement certain unfair dismissal remedies, such as reinstatement in case of employees in managing positions, and are not obliged to justify the reason of dismissal to works councils.	39
Sweden	Unfair dismissal: the "last-in-first-out" rule no longer applies to firms with up to 10 employees.	n.a.

in the long term as well as on working conditions for some workers. To counter the adverse effects of employment protection legislation on labour utilisation of certain groups and growth in general, reforming it is a priority, especially for regular contracts, in the Czech Republic, France, Greece, Japan, Luxembourg, Portugal, Spain, Sweden and Turkey. Reform options include moving towards a single contract where protection grows with seniority, *e.g.* by requiring employers to pay regular contributions to individual separation accounts that can be accessed in the case of layoffs, and reducing judicial uncertainty related to vague definitions of unfair dismissal in legislation.

High statutory minimum hourly labour costs, *i.e.* minimum hourly wages and social security contributions at that wage level, can reduce employment prospects of some groups, notably young people. Prompted by such concerns, some European countries have sought to reduce social security contributions on low earnings rather than reduce minimum wages relative to the average. Reducing relatively high minimum labour costs is seen as a priority for a few countries. More specifically, the minimum cost of labour should be reduced in France, Greece and Turkey by limiting the adjustment of minimum wages to below increases in average wage levels, lowering employers' contributions and/or introducing distinct minimum wages for young workers.

Extension of collective contracts to cover workers and employers not party to the original settlement risks establishing too high labour costs in some industrial segments and regions. More generally, to allow for better alignment of labour productivity and costs at the local level, it is a priority to reform bargaining arrangements in Australia, Belgium, Finland, Italy and Spain.

Summary

Given that priorities are identified based on performance weaknesses, their distribution across policy areas generally reflects the differences observed in the performance profiles.[9] Moreover, country groupings in terms of policy priorities broadly match those based on broad performance outcomes. For instance, policy priorities aimed at boosting overall labour resource utilisation remain more concentrated in Continental European countries. For countries with a large gap in GDP per capita, as well as in Japan and Switzerland, raising productivity is the main challenge and hence priorities tend to focus more on liberalisation of product markets, especially in network industries and services. English-speaking countries have generally good labour market performance, but raising the skills level in particular via an improvement of secondary education remains a common challenge. Finally, a large number of EU countries share the need to strengthen their higher-education systems in order to improve graduation rates and /or the quality of teaching and research performed.

On average across countries, between one and two of five priorities identified in *Going for Growth 2005* has been dropped from the current exercise. In the majority of cases that were dropped, some actions taken had already been reported in *Going for Growth 2006* or have been taken since then. Even though in many instances the reforms made have only partially addressed the identified weaknesses in the related policy settings, this has been enough to allow other policy areas to become more pressing issues. Furthermore, the extension of the exercise to the area of innovation, combined with an improvement in the set of indicators measuring policy areas already covered in the past, as well as a re-assessment of policy requirements has resulted in the exclusion of some priorities even though little or no action had been taken.

Notes

1. A more detailed review of the trends in growth performance and their sources is provided in Annex 1.A1. In absence of sufficient backward revisions available at the time of publication, the figures for Greece do not incorporate the major upward revision to national accounts announced by the authorities in the fall of 2006.
2. International comparison of economic performance measured in terms of GDP per capita and its main sub-components is facilitated by the use a country as a benchmark or “numeraire”. Owing to its size and position among the leading countries in terms of GDP per capita, the United States is a natural choice for a numeraire.
3. GDP per capita in these countries is boosted by special factors: oil extraction in Norway and cross-border workers and the financial market in Luxembourg.
4. Bourlès and Cette (2005), “A comparison of structural levels of productivity in the major industrialised countries”, OECD, *Economic Studies*, No. 41.
5. Evidence presented in Chapter 4 indicates that more competitive product markets may also boost labour utilisation.
6. For a more detailed discussion of the policy determinants of labour market performance (see Chapter 4).
7. The implicit tax on continued work is equal to the change in pension wealth over a certain period. The pension wealth is the sum of the flow of discounted pension benefits (or other *de facto* retirement benefits) less contributions to such benefit schemes. See Chapter 5 of *Going for Growth* 2005 for more details.
8. More recently, the share has stabilised in some of these countries (*e.g.* Australia). Among other countries for which data are available, only a few (*e.g.* Italy and Poland) have achieved a substantial reduction in the number of claimants during the first half of the 2000s.
9. Measures to strengthen labour market performance account for over one-third of all priorities, while those related to product market regulation, trade and innovation account for around one quarter. Education policies also remain an important area of policy priorities (around 15% of total) with an even split between secondary and tertiary levels. The remaining priorities are accounted for by recommendations in various fields not covered by indicators such as public sector efficiency, non-tariff trade barriers, public infrastructure and housing.

ANNEX 1.A1

Broad Trends in Growth Performance

This annex provides a description of broad trends in growth performance in the OECD countries. It first provides a brief overview of trends in aggregate GDP growth. It then examines the two key components of GDP per capita: labour productivity and labour utilisation.

GDP per capita and income

Most OECD countries have not achieved over the past ten years the substantial convergence on the living standards of the United States seen in earlier post-war decades. Trend GDP per capita has grown markedly faster than in the benchmark country only in the Czech Republic, Greece, Hungary, Ireland, Korea, Luxembourg, Poland and the Slovak Republic. Trend growth in Mexico and Turkey has been mediocre over the past decade especially considering the large potential for these economies to catch up, although there have been some signs of improvement over the past five years. Strikingly, living standards in a number of large economies, France, Germany, Italy and Japan, have not kept pace over the past decade with the trend increase in GDP per capita in the United States.

Convergence of GDP per capita is only a partial measure of the narrowing of the gap in living standards across countries. As discussed in the 2006 issue of *Going for Growth*, it measures income rather than wealth and even then it ignores incomes received from abroad or paid to foreigners. Nevertheless, the relationship between GDP and other measures of economic well-being such as net national income is close in all but a few notable cases. For instance, although Ireland has almost caught up with the level of GDP per capita of the United States, foreign investors now lay claim to a significant share of profits and therefore national income per capita has made less progress towards convergence. For the Czech Republic and Poland, the increase in net outward transfers of income over the past decade has also had a substantial effect in slowing the growth of national income relative to output. Changes in the terms of trade have had a material negative effect on the growth of real incomes in specialised ICT-producing countries (Finland and Korea) – partly offsetting the impact that this strong GDP growth performance has had on their wellbeing. In contrast, they have been beneficial over the past ten years for real income in resource-rich countries such as Australia.

Labour productivity

In most countries, the GDP-per capita gap is largely explained by weaker productivity compared with the United States. This includes non-US English-speaking and Nordic countries, as well low-income economies. Even in the Continental European economies

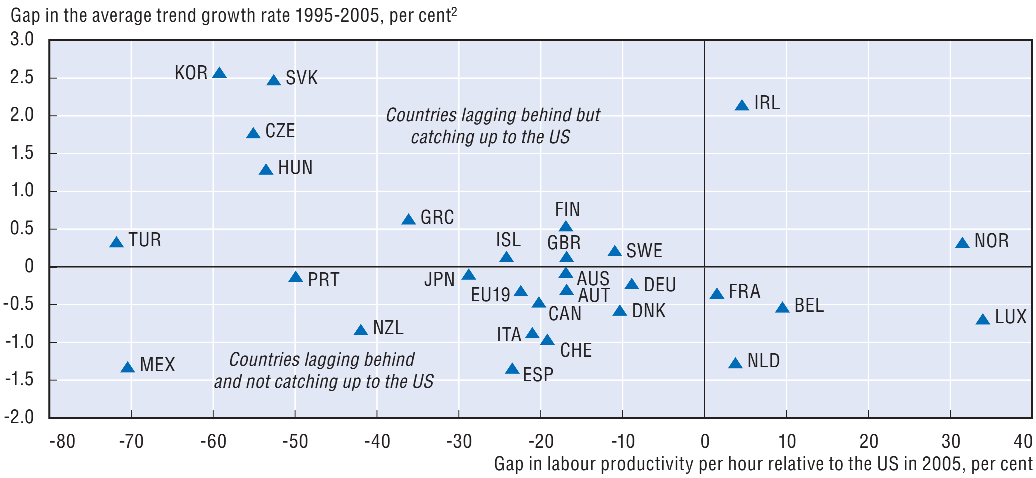
ECONOMIC POLICY REFORMS: GOING FOR GROWTH – ISBN 92-64-03047-6 – © OECD 2007

with measured labour/productivity close to the United States, it is likely that true productive capacity is lower taking into account low labour utilisation in these countries and lower-productivity workers being less likely to be employed (see main text).

Closing the gap in living standards with the United States over the past ten years, where it has occurred, has largely been achieved through relatively faster growth in labour productivity. To narrow the productivity gap over the past decade, countries have needed to make rapid improvements in output per hour as labour productivity in the United States accelerated from the mid-1990s and has accelerated further since 2000. Growth of output per hour has generally been fastest in countries with a low initial level of productivity and so the greatest potential to catch up (Figure 1.A1.1). But, the growth rate of labour productivity in even these countries still implies very slow convergence to the level of the benchmark country.* Labour productivity growth in Mexico has not even been sufficient to keep pace with the United States.

Figure 1.A1.1. **Labour productivity levels and growth rates**

Gap *vis-à-vis* the United States[1]



1. The average trend growth rate of labour productivity, measured as GDP per hours worked, is calculated on the basis of volumes data. Data for Greece do not take into account the 25% upwards revision to the level of GDP announced in 2006.
2. 1998-2005 for the Czech Republic, 1995-2004 for Mexico and Turkey; Poland is not included in the EU19, due to missing hours data in 1995.

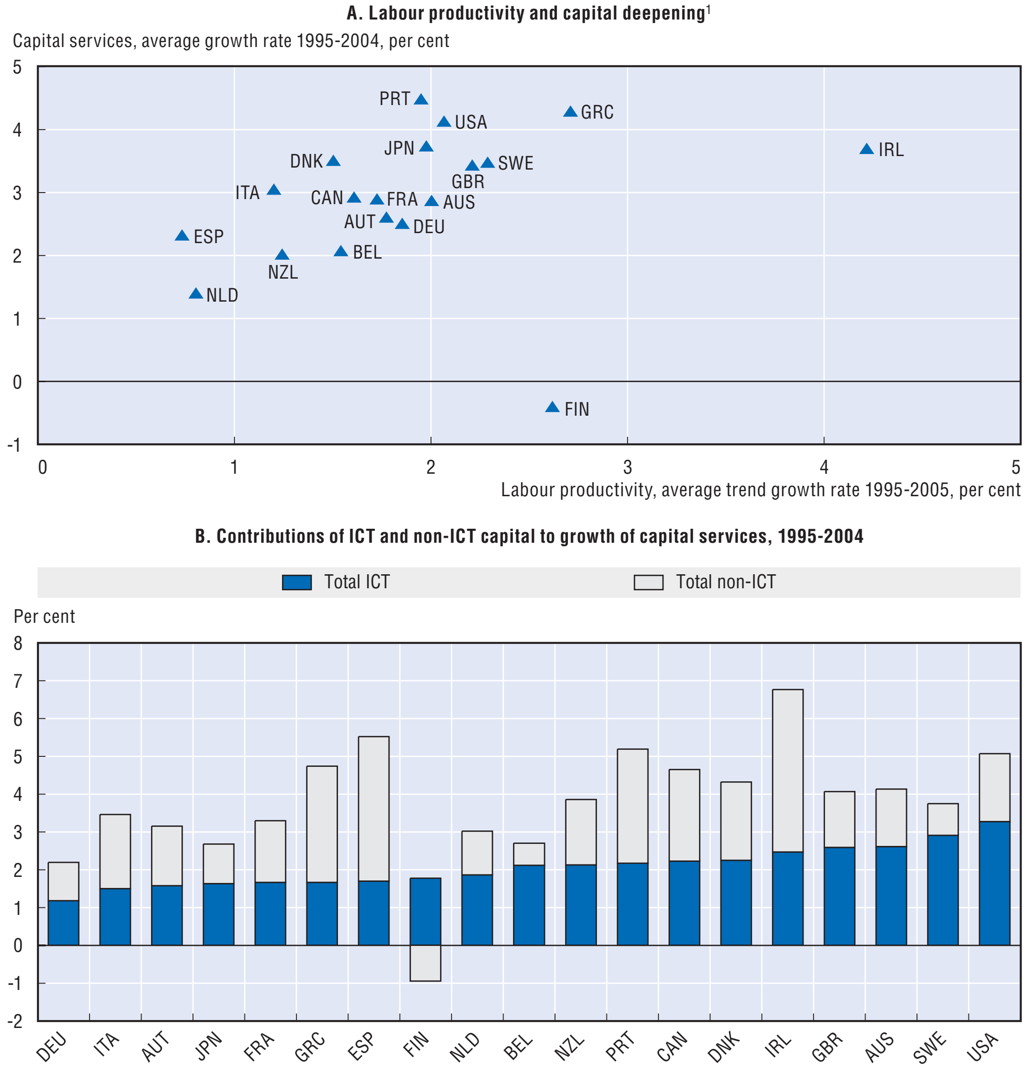
Source: *OECD Economic Outlook*, No. 80; OECD, *National Accounts of OECD Countries*, 2006.

The persistent weakness of labour productivity in the Netherlands and Spain over the past ten years may to some extent reflect progress in raising labour utilisation by drawing less productive workers back to work or delaying their retirement. This would tend to depress the measured average labour productivity and further distort the picture of true underlying productive capacity.

One reason for the failure of most countries to narrow the productivity gap is that the increase in capital intensity, *i.e.* capital services per hour worked, in the United States has been faster than in almost all other countries for which data are available (Figure 1.A1.2). This

* For example, even with the fifth highest rate of trend labour productivity growth in the OECD over the past ten years, Hungary would still take over a decade to reach half of the level of labour productivity in the United States.

Figure 1.A1.2. **The contribution of investment in physical capital**



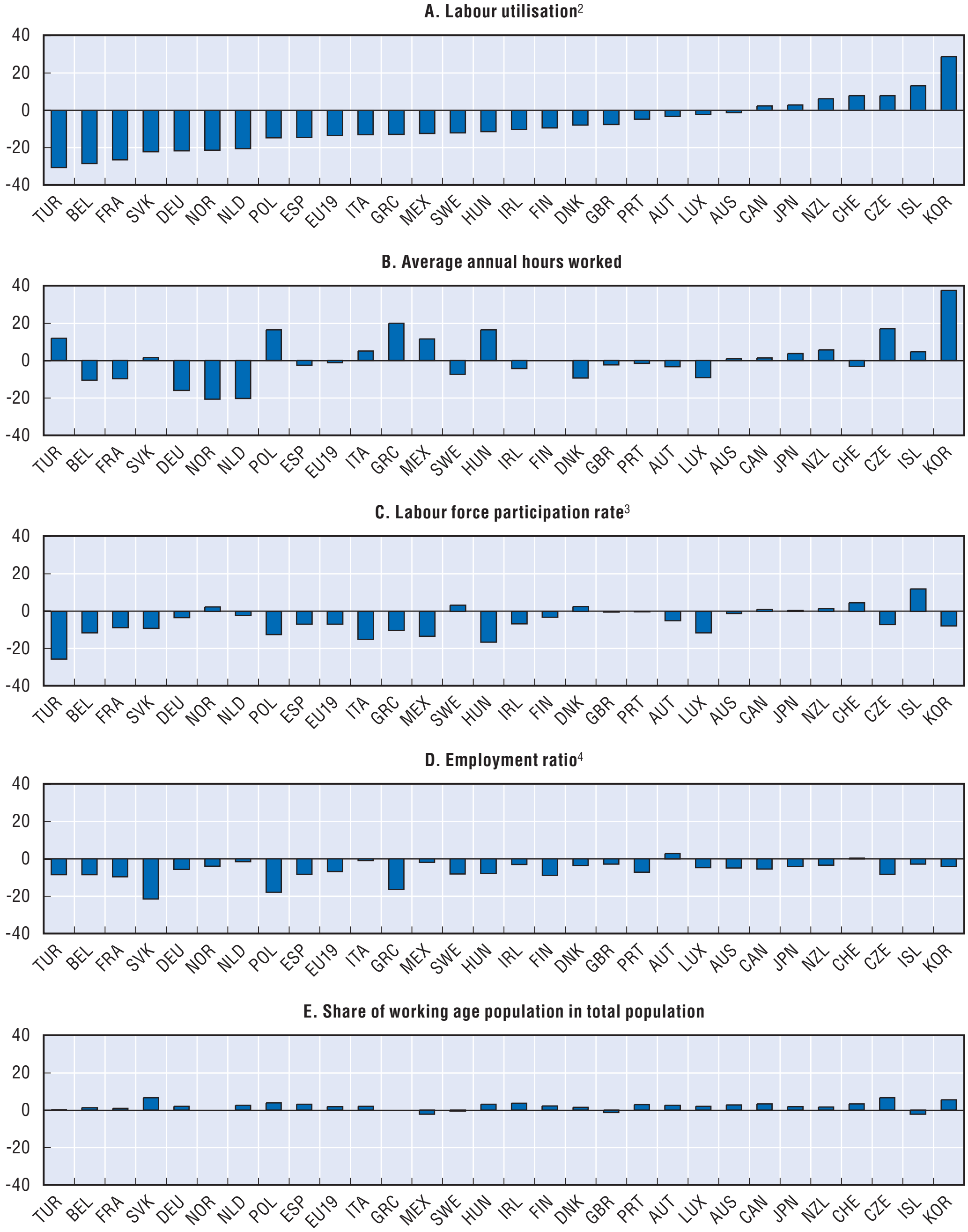
1. Labour productivity is defined as in Figure 1.A1.1. Capital deepening is measured as the growth rate of capital services less the growth rate of total hours worked.

Source: OECD, Productivity database; OECD, *National Accounts of OECD Countries*, 2006; and *OECD Economic Outlook*, No. 80.

strong performance has been associated with particularly strong investment in ICT equipment. Growth of capital services has typically been weaker in countries, such as in Continental Europe, where the contribution from ICT capital services has been less. Non-US English-speaking countries have experienced strong contributions to growth from ICT capital services but less than in the United States. For many countries, this weaker capital-deepening relative to the United States accounts for their relative weakness in labour productivity growth. In other countries (Canada, Denmark, Italy, the Netherlands, New Zealand, Spain and Switzerland) the relatively weak productivity growth performance is largely accounted for by substantially weaker growth in trend multi-factor productivity than in the United States. By contrast, trend multi-factor productivity has contributed substantially to the convergence of labour productivity for a small number of countries, such as Finland, Iceland, Ireland and Norway.

Figure 1.A1.3. **The sources of labour resource utilisation differences, 2005**[1]

Percentage gap *vis-à-vis* the United States



1. Countries are ranked on the basis of their labour utilisation. 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. Total hours worked during the year as a ratio of total population.
3. Population in the labour force as a ratio of working-age population.
4. Total employment as a ratio of the labour force.

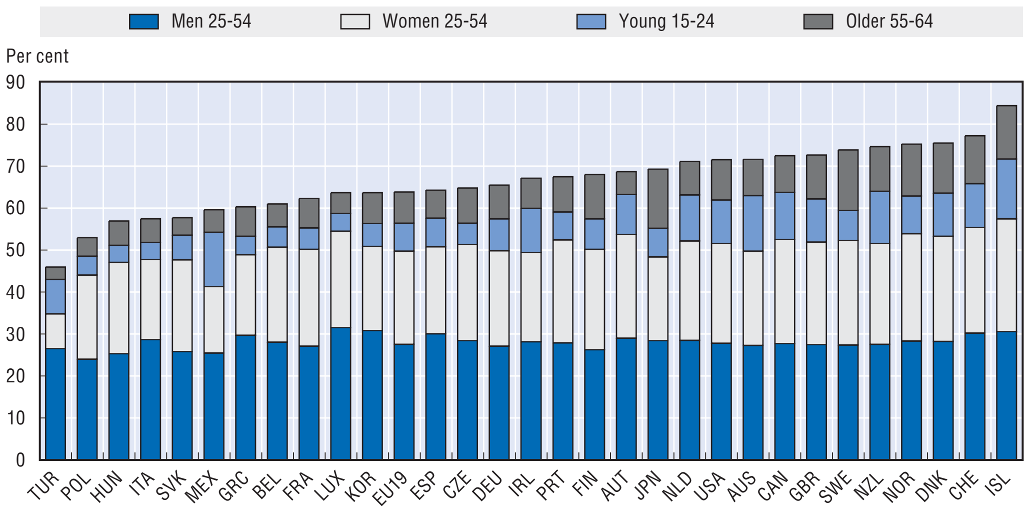
Source: OECD, Labour Force Statistics database and OECD, Productivity database.

Labour utilisation

In major Continental European countries the labour-utilisation gap, *i.e.* the smaller number of hours worked per person relative to the benchmark, is mostly explained by a combination of low average hours per person employed and low labour force participation (Figure 1.A1.3). Lower labour utilisation in Nordic countries is largely the result of low average hours worked per person employed as participation rates are typically relatively high. By contrast, the gap in low-income countries such as Hungary, Poland, Mexico and Turkey is explained by low labour-force participation as average hours worked per employed person are high. High unemployment has a substantial negative effect on the labour-utilisation gap in Poland and Slovakia.

The weak employment rates of some countries are largely explained by low employment of some specific groups, such as of younger workers, women and those aged 55 and over; the contribution of prime-aged males to employment is very similar across countries (Figure 1.A1.4). Female employment is relatively limited in lower-income, Asian and Mediterranean OECD countries. Employment of young and older workers is weak in some lower-income and Continental European countries. In addition to explaining much of the difference between countries, changes in employment for these groups also account for a large part of the increase in the overall employment rate. For example, overall employment rates have increased over the past ten years in Finland, Hungary, the Netherlands and New Zealand due in part to an expansion of employment of older workers.

Figure 1.A1.4. **Contribution of specific age/gender groups to overall employment rates, 2005**



1. Prime-aged workers defined as aged 25-54, older workers defined as aged 55 to 64.
Source: OECD, Labour Force Statistics database.

Overall, progress in raising labour resource utilisation has been mixed over recent years. While the labour market performance in the United States improved relatively strongly in the late 1990s, the trend employment rate and average hours per worker have both declined since 2000. Elsewhere, trend labour utilisation has increased over the past ten years in a few countries where it has been traditionally low (such as Ireland, the Netherlands and Spain). It has also risen in many countries with already good performance such as Canada and New Zealand. By contrast, trend labour utilisation has fallen further from an already low level in France and Turkey. Higher participation rates have tended to raise labour utilisation in most countries over the past ten years, helped by the modest fall in unemployment in many OECD countries. This increase in the proportion of people working has typically been at least partly offset by shorter average hours per person employed, which reflects to some extent the increased incidence of part-time work.

ANNEX 1.A2

Selection of Policy Priorities

This annex describes the process of selecting the policy priorities listed in Table 1.1 and discussed in detail in the country notes in Chapter 2. The five priorities are chosen on the basis of indicators and OECD expertise. The selection of priorities is based on two steps:

- Step one – identification of weaknesses in performance at an aggregate and/or at a disaggregated level based on international benchmarking.
- Step two – identification of potential policy priorities if poor performance is associated with policy settings that are weak by cross-country comparison.

Each step is discussed below under a separate heading.

Identification of performance weaknesses

The top-level indicator of performance is the comparative level and growth rate of GDP per capita *vis-à-vis* the United States. This country is chosen as the numeraire to assess relative performance because it has historically been among the leading OECD countries in terms of material living standards.

For priority selection, the gap in GDP per capita is broken down into its main sub-components: labour resource utilisation and productivity. A breakdown into sub-components allows for a finer assessment for performance and for the possibility to detect areas of weakness even in countries that are leading in terms of overall GDP per capita.

The labour-productivity gap, the difference with the numeraire country in terms of output per hour worked, can be further broken down into capital services available per hour worked and multi-factor productivity.

Likewise, the labour-utilisation gap, measuring the difference in average hours worked per person, can be further decomposed into three factors: the average number of hours worked per employee, total employment as a ratio of working age population, and the share of the working-age population in the total population.

The aggregate employment rate is supplemented as a measure of performance by group-specific employment rates that more precisely identify where the weakness in performance lies. Many of the differences in overall employment rates across countries and the changes in employment can be explained by specific groups, such as the young, women and older workers.

 ECONOMIC POLICY REFORMS: GOING FOR GROWTH – ISBN 92-64-03047-6 – © OECD 2007

Identification of policy priorities

Five policy priorities are then set for each country, addressing areas where performance weaknesses have been identified. Three of the priorities are selected on the basis of cross-country comparison of indicators of the stance of policies, confirmed by judgement and experience of country experts. The remaining two priorities primarily draw on country expertise, although they are often also supported by indicators. This allows some scope to select policy priorities in areas not covered by the set of indicators.

Selection of indicator-based priorities

Indicator-based priorities are set by comparing policies across OECD countries.

The comparisons are based on a set of around 50 policy indicators (see Chapter 3). These cover a broad range of policy areas such as labour market policies, education, product market regulation and health. The construction of these indicators draws on the expertise of a number of OECD directorates:

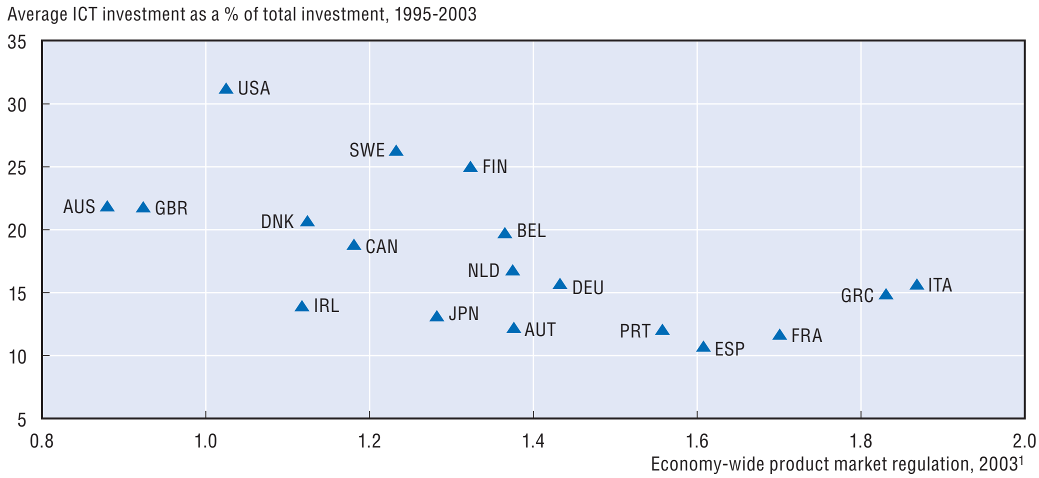
- Labour market performance and social conditions are monitored on a regular basis and the results reported in the *OECD Employment Outlook* and *Benefits and Wages*, as well as in other reports such as *Pensions at a Glance*.
- The extent and quality of education of the young and the wider populations are reviewed regularly and published in *Education at a Glance*, reports from the Programme for International Student Assessment (PISA), and country reviews.
- Developments in the taxation of labour income and standardised indicators of taxation are published in *Taxing Wages*.
- *Agricultural Policies in OECD Countries* monitors support to agriculture.
- Performance and policies in the area of science, technology and industry are reviewed in *Science, Technology and Industry: Outlook*; the *Information Technology Outlook*, the *OECD Communications Outlook*, and the *SME and Entrepreneurship Outlook*.
- Policies that affect regulation, competition and market openness are reviewed regularly and published in the series of *OECD Reviews of Regulatory Reforms*.

New indicators have been incorporated into the selection of indicator-based priorities for this edition of *Going for Growth*. These include indicators of innovation policies drawn from the analysis presented in *Going for Growth 2006*.

Indicators are intended to provide a quantitative summary of the stance of policy in a particular area. As such, they do not necessarily fully capture all the dimensions of a policy setting, nor the way in which policies are enforced in each country. Constructing indicators is a resource-intensive process and so it is not always possible to update them at a high frequency. As a result, indicators do not necessarily reflect all the recent developments in policy and some reforms will not be captured if they fall outside the dimensions considered in the indicator. Given these difficulties, it is essential to apply judgment and expertise in using indicators to set policy priorities. In this regard, matching policy priorities to weaknesses in performance helps to mitigate the effect of potentially misleading indicators by requiring that an indicator reading showing a poor policy should be matched by a weak performance in an area affected by the policy in question.

The matching of specific performance and policy areas is based on economic analysis of the impact of policies, supported by empirical evidence. Although multi-variate econometric analysis is usually necessary to establish a robust relationship between two variables, the link between policy settings and economic performance can be shown with a simple bi-variate example. As explained in detail in Chapter 5, economy-wide product market regulation (PMR) can limit competition. This reduces the incentive for firms to invest in ICT equipment and slows the process by which new technologies are adopted. Indeed, there is a clear negative relationship between PMR and the share of ICT investment in GDP as strict regulations reduce investment in ICT (Figure 1.A2.1). Using this particular match of performance and policy, countries having a relatively low share of ICT in total investment and at the same time, relatively stringent regulatory barriers to competition, could be selected as countries where easing product market regulation would be a candidate for a policy priority.

Figure 1.A2.1. **Relating policy to performance: product market regulation and ICT investment**



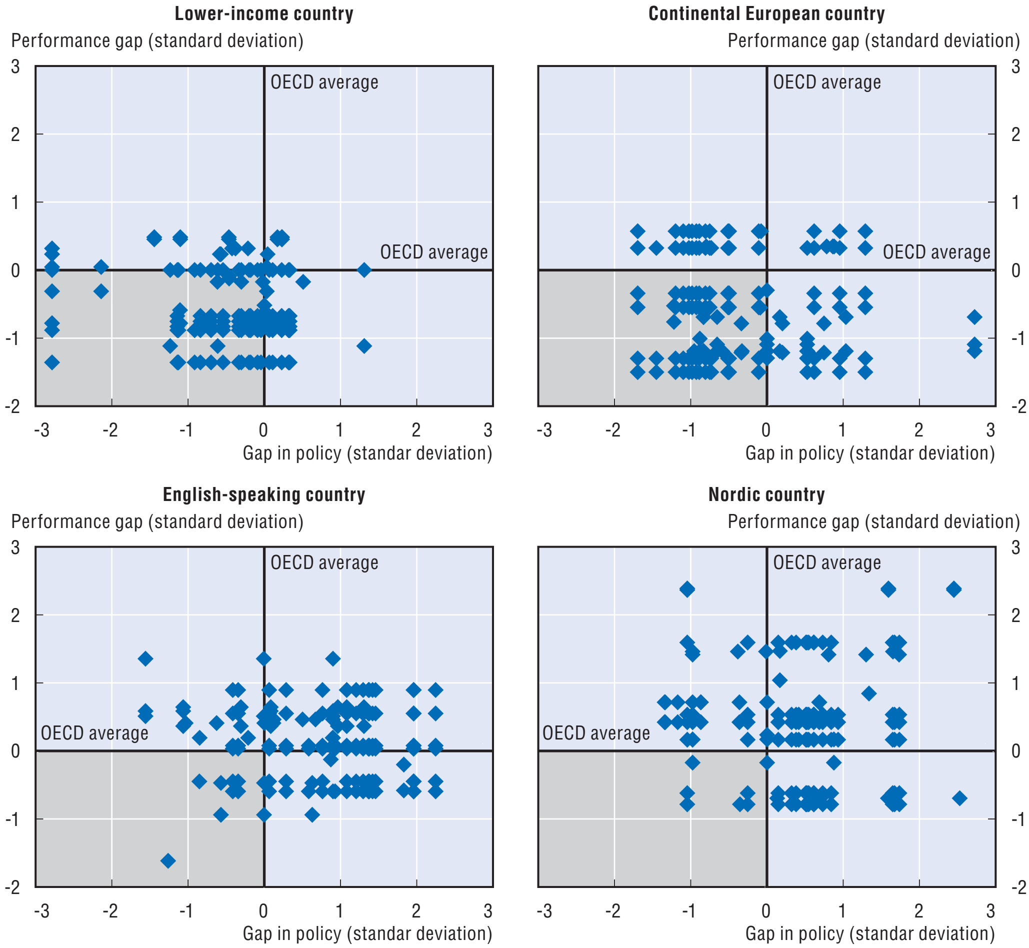
1. The scale of the indicators is 0-6 from least to most restrictive.

Source: OECD, Product Market Regulation and Productivity databases.

The identification of policy priorities for each country based on matching poor policy settings and weak performance can be further illustrated using examples from different types of economies (Figure 1.A2.2). Indicators of performance and policy settings are re-scaled so that each has a mean of zero and a standard deviation of one, and positive numbers indicate a position better than OECD average. Given that several policies may affect one measure of performance and that a single policy may affect performance in a number of ways, there is a large number of policy-performance matches to consider as priority candidates. In this framework, a policy setting is considered as a candidate for a priority if a sub-par performance in a specific area (*e.g.* ICT investment) is matched with an inadequate related policy setting (*e.g.* product market regulation), with the respective OECD averages used as benchmark.

Therefore, performance-policy matches falling in the lower-left quadrant of each panel of Figure 1.A2.2 indicate policy settings that could be considered as candidates for a priority. For instance, a *low-income* country typically has a large number of policy priority candidates, as the below-average level of income often reflects poor policy settings that lead to weak performance in key determinants of growth, such as labour productivity. By contrast, it is generally more difficult to identify candidates for policy priorities in *English-speaking* countries as these tend to have policy settings more favourable than the OECD average and also relatively stronger performance.

Figure 1.A2.2. **Examples of selection of candidates for policy priorities: matches of performance and policy indicators**[1]



1. Performance and policy gaps relative to OECD average, where positive numbers indicate position better than average. The bottom-left quadrant represents candidates for policy priorities. Indicators rescaled to have mean of zero and standard deviation of one across countries.

Continental European countries typically have policy settings that are somewhat less supportive of growth and employment than the OECD average so that, despite their above average level of income, there are still many candidates for policy priorities in these economies. *Nordic countries* show a number of policy settings that would generally be considered weaker than the OECD average but that are not selected because there is no corresponding relative weakness in performance, due to other policies and features of the economy.

Given the potentially large number of candidates for priorities in many countries, other information and criteria are then applied to identify the most pressing indicator-based policy priorities. For instance, the difference between the policy indicator and the OECD average can be taken as an indication of how far a policy setting is from good practice and how this compares with other policies. In general, policies furthest away from the benchmark are most likely to indicate a policy priority. Econometric estimates of the impact on performance of changing policy provide additional guidance in selecting the policies that would be likely to have the greatest impact on performance if they were raised to the OECD average. Finally, recent trends in policy and performance are further taken into account to determine policy priorities. For example, the increase in sickness and disability recipients over recent years is a matter of concern even if this is not always associated with a clear performance weakness in the countries where it has become a pressing issue.

Other key priorities

There will inevitably remain important policy areas that cannot be assessed on the basis of a quantitative indicator, even as the set of indicators expands. Two additional priorities are thus selected for each country, mostly drawing on the detailed expertise from OECD working committees and country experts. These will normally be issues that have also been addressed by the Economic and Development Review Committee and additional details and analysis can usually be found in the *Economic Survey* of the country concerned. In many cases, these priorities will also be supported by a policy indicator but in cases where they are not, judgment is used to determine the impact on a specific area of economic performance.

Implications and revisions to priorities

Setting an equal number of priorities for all countries is motivated by the desire to identify reforms that improve performance in all countries, the better-performing economies included. For countries with pressing performance problems and weak policy settings, this ensures that only the most important policies are retained and that a manageable agenda is identified, even if some important policy recommendations will be left out. For the best-performing countries, where areas of absolute weaknesses may be more difficult to identify, the policy priorities may appear less pressing.

Naturally, some of the five policy priorities differ from those identified when this exercise was last conducted. On average, between one and two priorities have changed per country since the previous publication. This reflects policy reforms and improvements in performance that make a particular issue less of a priority relative to others, even if reform is sometimes incomplete or does not necessarily fully address the weak performance. Expansion of the set of indicators and new analysis have also resulted in the introduction of new priorities, in innovation for example, that in some cases have greater importance than an earlier policy priority even where there has been no policy action.