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Introduction

In large parts of Europe the recovery remains uneven and fragile. According to the latest OECD projections (March 2015 Interim Economic Assessment), the recovery will gain some speed but remain sluggish, with Euro area growth reaching 1.4% in 2015 and 2.0% in 2016.

Europe still faces a substantial shortfall in demand with large excess capacity and euro area inflation persistently below target. There is a need to address the consequences of the crisis, including high unemployment, financial fragmentation and weak investment. Europe also faces substantial challenges in the medium term to achieve sustainable and more inclusive growth with an ageing population, a weaker outlook for productivity growth, and the growing role of emerging economies in global value chains.

To foster a stronger recovery, while boosting long-term growth prospects, a three-pillar approach is needed: supportive monetary policy, growth-friendly fiscal consolidation, and structural reforms. Although the job is not fully done, the pace of fiscal consolidation in Europe is in the process of easing as countries move closer, on aggregate, to pathways of fiscal sustainability. At the same time, the ECB, and many other European central banks, have adopted a more accommodative stance in the face of sustained disinflation and weak growth. Monetary and fiscal policy in Europe can therefore be expected to be more supportive of growth going forward than in recent years. The structural reforms will mainly boost potential growth over the medium-to-long term, thereby increasing the effectiveness of stimulus measures. Conversely, accommodative macro-economic policies are a key element of the success of structural efforts. In the absence of supportive demand conditions, there is little incentive for the resource reallocations which are fostered through structural reform. In this context, it is also important to design and plan structural reforms to have a positive impact on demand.

This note provides a summary assessment of Europe’s structural reforms, including (i) countries’ responsiveness to reform recommendations in recent years, (ii) a quantification of the economic impact of reforms and (iii) structural reform priorities going forward.
Europe’s recent track-record of structural reforms

Following a period of intense legislative activity in the aftermath of the crisis, partly driven by financial market pressures in the context of the euro area debt turmoil, EU countries are showing signs of reform slowdown. On average across the EU, the pace at which countries are implementing reforms has reverted back to its pre-crisis level. The slowdown was most pronounced in those countries that exhibited the highest levels and the strongest acceleration in reform after the crisis. By contrast, EU institutions themselves have kept up the relatively fast pace of reforms they adopted in the years following the crisis.

The reform slowdown was not an EU-specific phenomenon – in many non-EU OECD countries the pace of reform also decelerated in 2013-14 (Figure 1). The slowdown observed in many advanced countries coincides with some reform acceleration in emerging-market countries, including the BRIICS. China and India have been the most responsive to recommendations made in the OECD’s *Going for Growth* publication, a reflection of ambitious reform agendas by these countries’ governments.

**Figure 1. Despite a slowdown, the pace of reform is still high in some euro area countries**

Reform responsiveness index, from 0 (no action taken in areas covered by *Going for Growth* recommendations) to 1 (action taken in all areas covered by *Going for Growth* recommendations)

Note: Highly responsive euro area countries: Estonia, Greece, Ireland, Portugal, Spain; less responsive euro area countries: Austria, Belgium, Finland, France, Germany, Italy, Netherlands, Luxembourg, Slovak Republic, Slovenia; other European countries: Czech Republic, Denmark, Iceland, Hungary, Norway, Sweden, Switzerland, Turkey, United Kingdom; other OECD countries: Australia, Canada, Chile, Israel, Korea, Mexico, New Zealand, United States; BRIICS: Brazil, Russia, India, Indonesia, China. The grouping of euro area countries is based on the average responsiveness in the two periods.
Quantifying the impact of structural reforms

The OECD has been developing the tools necessary to quantify the impact of specific reforms – or packages of reforms – on GDP, productivity, employment and the distribution of income. Using these tools, the OECD, jointly with the IMF, provided an objective assessment of the impact of the policy commitments made by the G20 in the November 2014 Brisbane Action Plan. It was concluded that – if fully implemented – the proposed reform measures could raise overall G20 GDP by 2% by 2018.

The OECD also started including such quantifications as part of the OECD’s Better Policy Series (this could be as part of specific request from a reforming government, or as a contribution from the OECD) and has recently included these quantifications more regularly in the OECD Economic Surveys (e.g. Slovenia and Mexico). Recent examples of quantifications in Better Policy Series brochures include those for Portugal (July 2014), France (October 2014), and Italy (February 2015):

- **Portugal**: Following the economic crisis and the loss of access to financial markets, the Portuguese authorities embarked on an ambitious and fast-paced reform agenda. The impact of the product market reforms undertaken as a result was estimated at close to 3% of GDP by 2020 (Figure 2). Nonetheless, there is scope for further growth-enhancing measures. A move by Portugal to best practice among all OECD countries in the various areas and sectors covered by the OECD’s Product Market Regulation indicator would yield a further increase in the level of productivity and GDP of 5½ percent by 2020.

- **France**: Since 2012, the French government has undertaken or announced reforms to reduce regulatory barriers to competition, improve the functioning of the labour market, enhance the structure of the tax system and improve metropolitan governance. OECD estimates suggest that the reforms that had been adopted before October 2014 could raise the level of potential GDP by 1.2% over the next five years and 3% over the next ten years if they are fully and efficiently implemented (Table 1). This represents an average increase in the annual GDP growth rate of 0.2 percentage points over the next five years and 0.3 percentage points over the next ten years. Part of this growth effect would come through an increase in employment. However, there are significant implementation risks: not all of the reforms may ultimately be fully implemented and the actual effects could therefore be smaller.

- **Italy**: To improve Italy’s long-term growth prospects, Prime Minister Matteo Renzi’s government has set out an ambitious structural reform agenda across many policy areas including product markets, labour markets, taxation, public administration and civil justice, among others. The quantification exercise suggests that after five (ten) years, GDP would be 3.5% (6.3%) higher than would be the case in the absence of the reforms (Table 2). The number of additional jobs created over that period is estimated at 340,000. In the following five years a further gain of similar magnitude can be expected.

\[Figure 2. The expected gains from further product market reforms in Portugal are significant\]

**Impact on the level of potential GDP by 2020, percent**

<table>
<thead>
<tr>
<th></th>
<th>Further 20% reduction in strictness of regulation aligning Portugal to OECD best practice</th>
<th>Further reduction in strictness of regulation</th>
<th>Reforms undertaken since 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reforms</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Table 1. France’s recent structural reforms will boost potential GDP by 3% over the next 10 years

Impact on the level of potential GDP after 10 years, percent

<table>
<thead>
<tr>
<th></th>
<th>GDP</th>
<th>Via employment growth</th>
<th>Via productivity growth</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Product market reform</strong> (simplification shock, initial measures affecting regulated professions)</td>
<td>0.3</td>
<td></td>
<td>0.3</td>
</tr>
<tr>
<td><strong>Labour market reform</strong> (reduction of the tax wedge through CICE and Responsibility and Solidarity Pact; unemployment insurance reform; ALMPs)</td>
<td>1.3</td>
<td>1.8</td>
<td>-0.5</td>
</tr>
<tr>
<td><strong>Tax structure reform</strong> (corporate taxation; carbon tax; VAT increase; income tax relief)</td>
<td>0.4</td>
<td></td>
<td>0.4</td>
</tr>
<tr>
<td><strong>Public administration reform</strong> (metropolitan governance reform in Paris and Aix-Marseille)</td>
<td>1.0</td>
<td></td>
<td>1.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3.0</td>
<td>1.8</td>
<td>1.2</td>
</tr>
<tr>
<td><strong>Average annual growth</strong> (percentage points)</td>
<td>0.3</td>
<td>0.2</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Note: The quantification assumes full implementation of all reforms that were adopted before October 2014. The draft Macron Law remains under discussion and was not quantified.


### Table 2. Italy’s structural reforms will boost potential GDP by over 6% over the next 10 years

Impact on the level of potential GDP after 10 years, percent

<table>
<thead>
<tr>
<th></th>
<th>GDP</th>
<th>Via employment growth</th>
<th>Via productivity growth</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Product market reform</strong> (antitrust agency; regulatory oversight; reforms in telecom, gas, professionals services and retail sector; EU commitments in telecom, energy and rail transport sectors)</td>
<td>2.6</td>
<td></td>
<td>2.6</td>
</tr>
<tr>
<td><strong>Labour market reform</strong> (Jobs Act; reduction of the labour tax wedge)</td>
<td>2.4</td>
<td>2.7</td>
<td>-0.3</td>
</tr>
<tr>
<td><strong>Tax structure reform</strong> (tax on productive activities; Budget Law; <em>Delega Fiscale</em>)</td>
<td>0.4</td>
<td></td>
<td>0.4</td>
</tr>
<tr>
<td><strong>Public administration reform</strong> (single access point to facilitate entry of foreign investors)</td>
<td>0.9</td>
<td></td>
<td>0.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6.3</td>
<td>2.7</td>
<td>3.6</td>
</tr>
<tr>
<td><strong>Average annual growth</strong> (percentage points)</td>
<td>0.6</td>
<td>0.3</td>
<td>0.4</td>
</tr>
</tbody>
</table>

Policy priorities for Europe going forward

Productivity-enhancing structural reforms are the key to sustainable growth over the long term in advanced economies. However, some of them may widen output gaps from already high levels and reduce inflation further if they were to weaken aggregate demand. In addition, the full productivity effect of the reforms may take many years to materialise, making them sometimes a difficult sell to citizens. When pursuing structural reform, policymakers also need to take into account reform complementarities. For instance, product and labour market reforms are complementary in the sense that reforming just one of the two markets would imply that economic adjustment falls on the more flexible market. To avoid negative side effects such as higher unemployment, it is therefore crucial to reform both markets in a mutually supportive fashion. Research also shows that the pacing of reform matters. In particularly rigid markets, bold reforms are necessary to break through onto a path of higher growth, while timid reforms tend to enhance inequalities and may thus taper off to no reform effort at all, especially given political economy considerations.

Structural reforms not only will affect productivity, but also other policy objectives such as inequality and climate change. Given high and rising levels of inequality in many EU countries, reforms should be designed so as to avoid any negative impact on income inequality – both for social reasons and because higher inequality may dampen demand. While policies to foster the creation of more and better jobs directly entail “triple wins” (higher demand, higher potential output as well as lower poverty and income inequality), others may have negative-side effects on equality. For instance, while competition can promote inclusiveness by lowering prices, it also encourages firms to invest in new technologies and knowledge-based capital, which increases the demand for specific skills and render others obsolete. Effective active labour market policies that relocate displaced workers and support the formation of relevant skills need to accompany pro-competition reforms to fully reap their benefits.

Reforms also need to be designed so as to reduce pressures on the environment and support countries’ transition to a low-carbon economy. While economic growth usually comes with higher pressures on the environment, some growth-enhancing reforms such as increasing environmental taxes, introducing road pricing or removing harmful subsidies can be good for the environment by creating incentives to promote investment in green technologies. Other reforms, such as improving the rule of law or competition policies, also enhance the effectiveness of environmental policies.

Accounting for the above mentioned considerations, the OECD has identified the following policy priorities for Europe:

- **Boosting investment**: Support is expected to come from the Investment Plan for Europe. To ensure that the plan creates additional investment and does not simply make already planned projects more profitable, it will be important to select higher-risk projects, with commensurate higher social returns, which would not have been realized without the public guarantees. Funding alone is not sufficient to boost investment; institutional and regulatory change is crucial. Europe needs to make further progress toward a fully integrated European capital market to lower investment costs and channel capital to long-term projects. Improving the general business environment should also help stimulate investment; the administrative burden imposed on companies is still high in many EU countries, dampening both potential growth and demand through lower competition. The EU Commission’s recent initiatives (Impact Assessment system for new Commission proposals, EU Administrative Burden Reduction initiative, Regulatory Fitness Performance Programme) are welcome efforts, but deeper reforms that involve changes in policy design are also needed. Reinvigorating the Single Market is crucial in this respect. The implementation of the Services Directive needs to be improved, the internal energy market be strengthened and the co-operation between national regulators of network sectors be improved with a view to moving towards cross-border entities. Further simplification and harmonization of tax rules would also reduce costs for businesses.

- **Supporting SME’s and entrepreneurship**: New entrepreneurship financing methods need to be developed to reduce reliance on loan finance – which is particularly pertinent in the most vulnerable countries. By switching to non-bank financing instruments, for example mini-bonds, SMEs in some countries managed to overcome part of these financing constraints. Promoting the creation of SME asset-backed securities would both improve the functioning of the bank credit channel and also support a broader corporate bond market. Equity tools, which are hardly used in European markets also have the potential to provide financing for innovative and high-growth SMEs. But especially in Europe, there is a lack of a risk equity culture. Fostering private pension
savings and promoting education around equity investment could be a way to stimulate participation in growth markets. In addition, to the extent that investors’ return expectations are not compatible with what SMEs can deliver, the public sector might have to step in, for instance by guaranteeing for first losses on lending to SMEs. Governments also need to adjust bankruptcy laws towards best practice and give a chance for company restructuring.

- **Boosting trade**: Trade barriers are most prevalent in services sectors where both intra-EU trade and trade with third countries face significant trade costs. Trade barriers are particularly onerous in the professional services, where the licensing requirements vary considerably within the EU, making it difficult and costly to provide services across borders or establish a business in another country. The mutual recognition directive goes some way in mitigating the trade costs for intra-EU trade, but much more needs to be done to reform and open the professional services. In the telecoms sector some individual EU countries have well regulated and open telecommunications markets, but the EU market remains fragmented to the detriment of consumers as well as businesses. There is thus ample scope for benchmarking towards best practice also within the EU.

- **Bringing people back into work**: Urgent action is needed to strengthen the labour market attachment of groups that face significant employment barriers, such as the long-term unemployed, youth, women, migrants and older workers. Several countries have implemented significant reforms over the past few years, including Italy, Portugal, Spain and several countries from Central and Eastern Europe. The 2012 labour market reform in Spain for instance is estimated to have had a significant effect on employment, cutting the GDP growth threshold for creating employment in half, from around 2% to around 1% (De Cea and Dolado, 2013). Still, the position of young people in the labour market remains dire in some countries, giving rise to the risk of long-term ‘scarring’ of those unable to get an initial foothold in the labour market. Short-term measures to boost job creation need to be combined with reforms to enhance access to jobs, improve education outcomes and strengthen the compatibility between the skills acquired by students and those needed by business. In this context, the European Youth Guarantee is a very welcome step and should be fully implemented. Many EU countries are also drawing on the OECD Programme for International Student Assessment (PISA) and the Programme for the International Assessment of Adult Competencies (PIAAC). For example, Austria, Portugal and Spain have recently partnered with the OECD to carry out a Skills Strategy Diagnostic Report to build effective and integrated skills policies.

Figure 3 gives a snapshot at the skills level of adults as measured by PIAAC. It shows that many EU countries have ample room for improving their workers’ skills relative to the best performing countries. Figure 4 provides a glimpse of the extent of remaining regulatory restrictions, suggesting that notwithstanding the reform efforts of recent years, product market regulations can be eased further in many EU countries. A more detailed picture of countries’ restrictions on services trade is provided by the OECD’s Services Trade Restrictiveness index which measures at and behind the border restrictions to trade in 18 sectors (Figure 5).

**Figure 3. Some EU countries have room to improve their workers’ skills levels**
Mean proficiency scores of 16-65 year-olds, where a higher score implies better performance

Note: The scores for Belgium and the United Kingdom refer to respectively Flanders and England/Northern Ireland.

Figure 4. Strict product market regulation holds back growth in many EU countries
OECD Product Market Regulation index, from 0 (least restrictive) to 6 (most restrictive)

Note: The state involvement component covers public ownership, the governance of state-owned enterprises and government involvement in business operations (e.g. through price controls). The barriers to entrepreneurship component covers the complexity of regulatory procedures, administrative burdens on start-ups and the regulatory protection of incumbents. The barriers to trade and investment component covers at the border and behind the border barriers to trade and investment.


Figure 5. Many EU countries still impose heavy restrictions on services trade
OECD Services Trade Restrictiveness index, from 0 (least restrictive) to 1 (most restrictive)

Note: The EU and OECD averages are computed as unweighted averages of the total STRI scores across all EU and OECD countries, respectively.

Source: OECD Services Trade Restrictiveness database.

Looking at the reform recommendations made in the OECD’s Going for Growth publication for individual EU member countries shows that about a fifth of reform priorities refer to social benefits and active labour market policies (ALMPs). This is more than double the share of this area in the priorities of non-EU members of the OECD (Table 3). Another fifth of EU countries’ reform priorities refers to product market reforms, trade and FDI measures – a share similar to that of non-EU OECD countries. For EU countries, there is also a much stronger emphasis than elsewhere on tax reforms, particularly those targeting the level of labour tax wedges.
## Table 3. Europe’s Going for Growth reform priorities are concentrated in two areas – social benefits/ALMPs and product market regulation/trade/FDI

In percent of the total number of policy priorities of the geographic area, 2015

<table>
<thead>
<tr>
<th></th>
<th>OECD</th>
<th>EU OECD</th>
<th>Non-EU OECD</th>
<th>Non-OECD</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Labour utilisation</strong></td>
<td>39</td>
<td>49</td>
<td>22</td>
<td>20</td>
</tr>
<tr>
<td>Tax system (emphasis on the level of labour tax wedges)</td>
<td>7</td>
<td>11</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Social benefits and active labour market policies</td>
<td>17</td>
<td>21</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>Policy barriers to full-time female participation</td>
<td>5</td>
<td>4</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>Labour market regulation, collective wage agreements</td>
<td>9</td>
<td>10</td>
<td>6</td>
<td>10</td>
</tr>
<tr>
<td>Housing and planning policies, barriers to labour mobility</td>
<td>2</td>
<td>4</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Productivity</strong></td>
<td>61</td>
<td>51</td>
<td>78</td>
<td>80</td>
</tr>
<tr>
<td>Human capital</td>
<td>16</td>
<td>15</td>
<td>17</td>
<td>15</td>
</tr>
<tr>
<td>R&amp;D and innovation policies</td>
<td>6</td>
<td>5</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>PMR, trade and FDI</td>
<td>21</td>
<td>20</td>
<td>23</td>
<td>23</td>
</tr>
<tr>
<td>Agriculture and energy subsidies</td>
<td>5</td>
<td>1</td>
<td>11</td>
<td>3</td>
</tr>
<tr>
<td>Tax system (structure and efficiency)</td>
<td>5</td>
<td>2</td>
<td>11</td>
<td>5</td>
</tr>
<tr>
<td>Efficiency of public spending</td>
<td>4</td>
<td>3</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>Public infrastructure</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>13</td>
</tr>
<tr>
<td>Legal infrastructure and rule of law</td>
<td>1</td>
<td>0</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Financial markets regulation</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>8</td>
</tr>
<tr>
<td>Housing and planning policies, barriers to labour mobility</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>3</td>
</tr>
</tbody>
</table>

Note: EU OECD includes recommendations made to the EU as a whole. Non-OECD corresponds to recommendations made to BRIICS countries plus Colombia and Latvia.
Further reading


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