Economic Policy Reforms
Going for Growth - 2006 Edition

Summary in English

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Over the past two decades, living standards in a number of OECD countries, notably Japan and some Continental European economies, have fallen further behind the best performers. At the same time, potential growth has improved in other OECD countries. This divergence in performance holds policy lessons for how best to spur sustained growth in living standards.

The first issue of *Going for Growth*, which was released one year ago, brought out some of these lessons. It inaugurated a new form of benchmarking surveillance, complementing the OECD's long-standing country- and sector-specific surveys. Using structural policy indicators with a well-identified link to economic performance, alongside the detailed expertise of the OECD's committees and staff, a set of five policy recommendations is derived for each OECD member.

In last year's edition, the focus was put mainly on labour and product markets. This second issue follows up on the progress made in those areas. In addition, it broadens the scope of indicators underpinning the structural surveillance exercise to take into account policies that stimulate innovation, long recognised as one of the main engines of growth. In the same spirit, albeit more tentatively, this issue of *Going for Growth* also explores how regulation of activities in this area affect economic growth. Lastly, it takes a few steps back to reflect on the yardstick used in the course of surveillance to measure success.

Chapter 1 provides an overview of the progress that countries have made over the past year in taking measures that are in line with the policy priorities identified in the 2005 edition of *Going for Growth*. Progress in reforming policies to improve labour productivity performance and labour utilisation is reviewed with the key findings summarised as follows:

– With respect to policy priorities to raise labour productivity, moves consistent with the identified policy priorities are underway or have already been made towards easing controls on entry in product markets and other competition-restraining regulations, strengthening human capital formation and reforming various other policy areas that affect labour productivity.

- With respect to policy priorities to raise labour utilisation, reforms along the lines of the identified policy priorities, especially for Continental European countries, have in most cases neither taken place nor been planned. For example, few moves are underway to reduce the still high implicit tax on working beyond certain ages, tax wedges and labour cost floors A greater reform tendency can be observed in the area of disability and sickness benefit systems.

The overview is based on notes for each OECD country (and the European Union as a whole) that give more details on progress for each of the five specific priorities (*Chapter 2*). In addition to the passing of legislation or other decisions to implement reforms, the individual country notes document earlier stages of reforms, such as government announcements and draft legislation presented to parliaments.

Chapter 3 provides a cross-country comparison of innovation efforts and outcomes as well as of the main policy areas having an influence on those outcomes. Innovation has long been a key source of progress in material living standards but the outcomes of innovation efforts are generally highly uncertain and the benefits for society as a whole may exceed those for private firms. To encourage innovation, governments have therefore put in place various measures such as financial support for private R&D projects and funding for research in public institutions. Also, patent laws and other legally enforceable measures provide innovators with time-limited, exclusive rights over the exploitation of their innovation.

In recent years most policy attention has been dedicated to raising the effectiveness of these and other measures so as to improve the efficiency of innovation systems. This has entailed not only refinements to instruments for financing R&D, but as well the implementation of policies to strengthen interactions between public research organisations and industry.

The analysis of the main drivers of innovation reviewed in Chapter 3 has been used to identify a set of country-specific policy recommendations to foster innovation. These recommendations for all OECD countries are formulated in individual country notes reported in *Chapter 4*. The same approach as for labour and product markets was adopted: identified weaknesses in the policy settings coupled with sub-par innovation performance or weaknesses in the proximate determinants of innovation (such as skills or financial conditions) are taken to suggest that reforms are called for to move closer to best practice.

Looking at innovation outcomes and the identified policy recommendations, the following country groupings emerge:

- Leading innovators include the Nordics, the United States and Japan. Most of them have enjoyed strong productivity growth over the past decade (Japan being an exception). And most of them exhibit high graduation rates from tertiary education. Several, however, face the challenge to boost innovation in services.
- At the other end of the innovation performance spectrum, improvements in education are called for in Southern Europe, and stronger product market competition in Central Europe.
- In the middle lie English speaking countries other than the United States, where productivity performance has generally been good. A common challenge there is to strengthen the links between public research and industry.
- The remaining countries – notably France and Germany – tend to display above-average innovation performance, but need to strengthen tertiary education. Most of

them can also improve the cost-effectiveness of the financial measures taken to support private sector R&D.

Chapter 5 sheds some light on the link between financial market regulation and economic growth. Financial systems are found to differ substantially across OECD countries in terms of overall size, structure as well as in the degree of competitive pressures prevailing in the banking and securities markets. To some extent, these variations reflect differences in regulatory underpinnings. In particular, regulatory settings that maintain excessively high barriers to competition in banking, or that provide too little protection for investors in securities markets, hamper the development of financial systems, resulting in weaker economic growth. In fact, the Chapter reports findings from empirical analysis showing that sectors that are more dependent on external finance grow faster in countries where regulation is more conducive to financial development.

Chapter 6 assesses the extent to which GDP per capita serves as a reasonable proxy for overall well-being. Other national accounts measures area arguably better suited for this purpose but they are not readily available and are in any case closely correlated with GDP in most OECD countries. Illustrative calculations to “extend” GDP to include leisure time, the sharing of income within households and distributional concerns suggest that cross-country ranking based on these indicators and GDP per capita are generally similar. Overall, GDP per capita remains critical for any assessment of well-being but needs to be complemented with other measures to get a comprehensive picture of well-being.

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