# Executive summary

Structural reform priorities to boost real incomes have been identified by the OECD through the *Going for Growth* analysis since 2005 for each OECD country and, starting with the 2011 edition, the BRIICS – Brazil, China, India, Indonesia, Russia and South Africa, key non-member countries with which the OECD works closely. This process provides a tool for governments to reflect on policy reforms that affect their residents' long-term living standards. *Going for Growth* analysis has been used in the Mutual Assessment Process of the G20 since the 2008 Pittsburgh Summit.

This new edition of *Going for Growth* assesses progress that countries have made on structural reforms since the start of the crisis, covering the whole period 2007-11. The crisis has delivered new policy challenges and lessons, but it has also made the necessity of many *Going for Growth* priorities more apparent. The main reform patterns that emerge over the years since the start of the crisis, which are summed up in an overview chapter (Chapter 1) and described in greater detail in individual country notes (Chapter 2), are as follows:

- The pace of reform, as measured by the responsiveness of countries to reform priorities identified in previous issues of *Going for Growth*, was greater overall after than before the crisis.
- The pace and the nature of reforms have varied markedly throughout the distinct phases of the crisis, however. The 2008 recession at first slowed down structural reforms in OECD countries, with the main preoccupations being the pressing need to stabilise aggregate demand and provide income support to the unemployed. As the need for medium-term fiscal consolidation became more pressing, reforms were implemented in policy areas which could help assist the fiscal adjustment process, such as retirement schemes, welfare systems and public sector reforms.
- The crisis and ensuing sluggish recovery have acted as a catalyst for structural reforms especially in OECD countries where reforms were most needed. Lower-income OECD countries, which are generally in greater need of reform, and those countries that saw unemployment rise most during the crisis, have acted more on their relevant *Going for Growth* priorities.
- The need to consolidate public finances and the financial pressure arising from mushrooming sovereign debt have given another impetus to reform since 2009, contrasting with past evidence that fiscal tightening tends to hold back reforms. In particular, the most recent phase of the crisis has seen an acceleration of politically sensitive reforms designed to help lift potential growth, regain price competitiveness and restore fiscal sustainability in countries affected by the European debt crisis.

- The impact of the crisis was both milder and shorter in the BRIICS, but it also made more apparent the necessity of measures that could deliver more inclusive growth. All emerging economies covered here have implemented policies aimed at enhancing the quality and inclusiveness of their education systems, but less has been done to address other important priorities, such as the reduction of barriers to foreign direct investment and the enhancement of the rule of law.
- Given what has been done in recent years, priority should be given to policies that can boost jobs in the context of ongoing fiscal consolidation:
  - ❖ Effective active labour market policies aimed at retraining displaced workers and encouraging return to work can reduce unemployment persistence. There is a case for sheltering such policies from fiscal consolidation efforts, and for complementing them with unemployment benefit reforms once recovery in labour market demand is solid. In particular, crisis-related increases in benefit levels and/or duration could be gradually phased out while some of the recent extensions in the coverage of unemployment benefits could be made permanent.
  - ❖ Growth-friendly tax reforms could help strengthen the jobs content of a recovery, while also helping fiscal consolidation insofar as they are implemented in a way that raises tax revenue. These include removing tax expenditures and shifting the tax burden towards tax bases that are less harmful to employment and growth, such as immovable property, consumption and environmental taxes.
  - ❖ Product market reforms are a priority for many OECD countries – in particular in Europe, and could have fairly rapid effects on growth, especially if implemented in certain sheltered sectors such as retail trade and professional services where the potential to quickly create jobs is rather high.
  - ❖ In economies that experience renewed economic slack, it will be important that the policy response draws on the lessons from the crisis as to what works in terms of cushioning the labour market impact of weak activity, such as making use of short-time working schemes.

While the crisis has made the necessity of structural reforms more apparent and provided an impetus to action, concerns have been raised that some of them could be detrimental in the short term, for instance if they further weaken aggregate demand. Drawing on 30 years of reform experiences across OECD countries, Chapter 4 sheds light on the short-term impact of structural reforms. It provides a number of policy lessons on how to design the current reform agenda in ways that would help kick-start the recovery:

- Concerns about possible negative short-term effects of structural reforms seem exaggerated. Some structural reforms appear to boost growth fairly quickly, while usually very few if any have short-term costs.
- The benefits from reforms often take time – typically several years – to fully materialise, however.
- Also, cyclical conditions matter for the short-term effects of reforms. There is some evidence that in "bad times", certain labour market reforms (of unemployment benefit systems and job protection in particular) can make the economic situation temporarily worse. In still depressed economies and unless current policies are clearly seen as aberrant, it may be preferable therefore that such reforms be carried out only once the labour market shows clear signs of recovery.

- A well designed package of labour and product market reforms would deliver the largest gains and alleviate the transitional costs of certain individual reforms – for instance, liberalising product markets alongside job protection or unemployment benefit reforms can mitigate possible real wage declines associated with the latter.
- The short-term impact of structural reforms will be stronger if an effective communication strategy and a strong and well-regulated banking sector foster confidence and induce households and firms to spend against future reform-driven income gains.

The recognition of widening income gaps within most OECD countries over the past decades has highlighted concerns that structural reforms – and therefore some of the *Going for Growth* priorities – may increase income inequality. Such concerns have gained further prominence in the context of the crisis, particularly in countries where current reform action is being driven primarily by fiscal consolidation objectives. Chapter 5 examines complementarities and trade-offs between reducing inequality and promoting economic growth:

- Many structural reforms entail a double dividend as they reduce income inequality while at the same time boosting long-run GDP per capita. Examples include facilitating the accumulation of human capital notably at the secondary level, improving the efficiency and the equity of education, reducing labour market dualism, promoting the integration of immigrants and fostering female labour market participation. Reducing tax expenditures along with reducing marginal tax rates also typically contributes to both goals.
- By contrast, other reforms may entail a trade-off between growth and income distribution objectives. For instance, shifting the tax mix away from labour and corporate income taxes towards consumption taxes improves incentives to work, save and invest, but can undermine equity. However, cash transfers targeted to lower incomes can be used to ease this trade off.

The distribution of income is not only shaped by long-term trends like changes in policies and institutions, technological change or globalisation, but is also affected, sometimes durably, by macroeconomic shocks such as the recent financial crisis. Based on empirical analysis for 40 OECD and BRIICS countries over 30 years, Chapter 6 explores the distributive effects of macroeconomic shocks on both income and employment, and the role of policies and institutions in shaping them. The Chapter identifies who gains and loses, and sheds light on the articulation between risk-sharing and growth objectives:

- Incomes of the poor and jobs of the young have in general been most affected in bad times, although they have also risen more strongly in good times. In the case of past financial crises, both high-income households and the poor have been hurt more severely than middle classes.
- Reforms that can improve risk sharing while also benefiting growth and jobs, not least by facilitating the reallocation of labour across the economy, include liberalising product markets, removing barriers to trade and FDI and lowering high taxes on labour.
- Many social protection programmes appear to have mitigated the job or income losses of vulnerable groups in the wake of past shocks, but since such schemes can come at a cost in terms of jobs and income particular care is needed in designing them. This is especially the case for generous unemployment benefits, high minimum wages and strict job protection.

- Countries can be classified in four groups, depending on the extent to which their policy settings provide social protection and facilitate labour reallocation. Most countries of continental Europe provide income risk sharing primarily *via* social protection programmes, while English-speaking and Asian OECD countries rely mainly on reallocation-facilitating institutions. Nordic countries tend to have both, while in emerging countries neither class of institutions are developed. An effective policy mix to deliver on both risk-sharing and growth objectives combines reallocation-facilitating institutions – which always benefit both goals – and a well-designed social protection system – *i.e.* one that achieves a given insurance objective at minimum cost.