Economic Policy Reforms 2013
Going for Growth

Chapter 1

Taking stock of reform action and identifying priorities in 2013

This chapter assesses progress that countries have made in responding to Going for Growth policy recommendations since 2011. Against this background, it identifies and discusses new priority areas where structural reforms are needed to lift growth across OECD and BRIICS countries.

Key policy messages

- Structural reforms have accelerated over recent years, with the euro area debt crisis acting as a potent catalyst.
  - ❖ For OECD countries, action on reform priorities stands currently at its highest levels since the launch of the *Going for Growth* exercise in 2005. This achievement is to be seen in a context where a number of euro area periphery countries who urgently need to revive post-crisis growth have been actively reforming to regain price competitiveness and restore fiscal sustainability. By contrast, progress has been weak in other euro area countries, where reforms are also needed in order to achieve intra-euro area rebalancing.
  - ❖ Appetite for reform in the BRIICS is varied but on average only moderate, potentially reflecting the comparatively milder crisis-induced pressure to reform.
  - ❖ Reform intensity has been noticeably high in the areas of wage bargaining and job protection legislation as countries seek to reduce labour market duality, boost job creation and facilitate the reallocation of resources towards growing sectors. Pension reforms were already ongoing at the onset of the crisis and have accelerated under the pressures to ensure debt sustainability.
  - ❖ The need to put public budgets on a sustainable path and regain competitiveness has also been a major driver of productivity-enhancing reforms in a number of OECD countries. Governments have increased the efficiency of taxation, encouraged competition in product markets and improved cost-efficiency in the public sector.
- Against the background of reform action and with a view to sustainably revive growth and reduce unemployment in a context of quasi-stagnation, the general orientation of the new structural policy priorities can be summarised as follows:
  - ❖ For most European countries, the need to raise labour utilisation remains a pressing challenge. Recommendations to reform tax and benefit systems, active labour market policies and job protection legislation are therefore quite common. Product market reforms also feature prominently, not least in areas where they can deliver rapid employment gains. A number of these recommendations, *e.g.* in the area of active labour market and training policies and regulatory barriers to entry in retail trade or professional services, would also help countries that have suffered a sharp increase in the unemployment rate and in the incidence of long-term unemployment.
  - ❖ In other advanced OECD countries, especially in Asia, there is a greater focus on labour productivity and hence reforms of network sector regulation, of foreign direct investment (FDI) restrictions and of public support to agriculture.
  - ❖ For relatively low-income OECD countries and the BRIICS, the main challenges concern the quality and inclusiveness of education systems, the capacity and regulation of infrastructures and the prevalence of high barriers to competition and

investment for domestic and foreign firms. Also, a number of recommendations (*e.g.* in the areas of tax and benefit systems and job protection) are formulated with a view to reducing the heavy economic and social costs associated with informality.

Introduction

Structural reforms have gained momentum in the aftermath of the recent recession. This has been driven in part by market pressures in the context of the euro area crisis and by discussions and co-ordinated efforts in multilateral settings such as the G20.[1] There is increasing awareness of the necessity to accompany macroeconomic stabilisation policies with structural reforms. Yet, given the weakness of near-term demand prospects, the limited scope for macro policies to further stimulate demand and the still less than fully functioning financial sector in many countries, there is a risk that the benefits from reform may take more time to materialise than in a normal conjuncture. Some of them may even depress short-term growth despite their beneficial long-term effects (see Chapter 4 of *Going for Growth* 2012, OECD, 2012a). It is therefore important that structural reforms be well motivated and communicated so as to boost confidence and maximise the short-term positive impact.

Going for Growth reports have been published by the OECD every year since 2005. The analysis identifies five structural reform priorities to boost real income for each OECD country, for the European Union as a whole, 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. Policy recommendations are identified based on their ability to improve long-term material living standards through higher productivity and labour utilisation and broadly cover the areas of product and labour market regulations, human capital, tax and benefits systems and innovation policies. Financial market regulation does not generally feature prominently among country-specific priorities, owing to the particular need for strong international co-ordination in this area (see OECD, 2011a, 2012a).

Even though policy priorities are established with a view to foster long-term economy-wide gains in living standards, some of them may also help addressing other objectives. For instance, some structural reforms can help to tackle global and intra-euro area macroeconomic imbalances, or ease concerns about growing inequality, as discussed in Chapter 2 of this report.

This chapter first provides a broad assessment of the progress that countries have made in structural reform priorities identified in 2011– *i.e.* in the last priority-setting exercise. It then looks briefly at variations in labour productivity and labour use across OECD and BRIICS countries, in order to understand the relative areas of performance weaknesses by country. Against this background, it finally discusses the general orientation and focus of the policy recommendations that result from mapping performance weaknesses to policy deficiencies for each individual country.

Progress on reform priorities since 2011

Measuring progress on priorities

In order to summarise progress on implementing priorities, a "responsiveness rate" indicator is constructed for each individual priority area, each broad reform field (labour-productivity or labour-utilisation enhancing reforms) and each individual country (Box 1.1).

Box 1.1. **Two indicators of reform action**

The reform responsiveness rate indicator is based on a scoring system in which recommendations set in the previous edition of *Going for Growth* take a value of one if "significant" action is taken and zero if not. Given that a single priority may entail more than one specific recommendation, the scoring is often based on more than one reform opportunity per priority area.

The following section focuses on actions taken on 2011 recommendations, hence it covers two years (2011 and 2012). It also offers a partial comparison with earlier periods. However, such longer comparison can be established neither for the countries that joined the OECD during 2010 (Chile, Estonia, Israel* and Slovenia) nor for the BRIICS because priorities were identified in 2011 for the first time for those countries.

Some policy areas have traditionally been politically more difficult to reform than others. Thus, the extent to which countries have followed up on priorities may be shaped by their nature. For instance, a country with recommendations in the areas of innovation and infrastructure might be expected to be more responsive than another country with similar appetite for reform but with priorities in the areas of job protection and wage formation, where political economy obstacles to reform are stronger. In order to account for this possibility an "adjusted" responsiveness rate has also been computed. This weighs responsiveness on each individual priority according to the difficulty of undertaking the relevant reform. The difficulty is measured by the inverse of average responsiveness to priorities in this area in non-crisis circumstances across the OECD or the BRIICS. The adjusted indicator is based on the hypothesis that the difficulty to reform in each policy area is the same across countries, clearly a debatable assumption, but one that cannot be easily avoided.

Both reform responsiveness indicators are a measure of the extent to which OECD countries have followed up on *Going for Growth* recommendations, but they do not aim to assess overall reform intensity *per se*, which would require both accounting for reforms carried out in non-priority areas and quantifying the importance of each individual measure. While the indicators are imperfect substitutes for proper reform assessments, they are used here because of their direct comparability across countries and timeliness.

For more details see Box 2.2 and Annex 2.A1 in *Going for Growth 2010*. The cut-off date for the information feeding into the indicators was 31 December 2012.

* The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

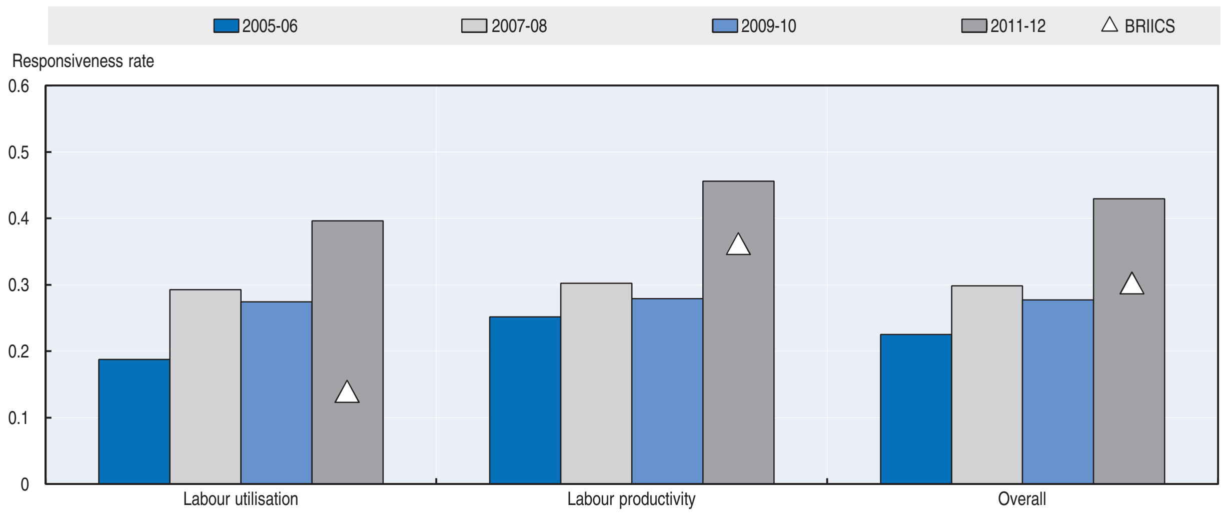
Source: OECD (2010), *Economic Policy Reforms 2010: Going for Growth*, OECD Publishing.

Reform patterns across OECD countries and the BRIICS

Overall, reform patterns show that the weak post-crisis recovery and, especially, the euro area debt turmoil, continue to act as catalysts for structural reforms in OECD countries, reinforcing the findings from last year's edition (OECD, 2012a). Following an initial slowdown in the early stage of the recession (2008-10), there has been a substantial pickup in reform intensity on average across the OECD, with responsiveness reaching its highest rate since 2005 (Figure 1.1), reflecting an increase in response to both labour productivity and labour utilisation – enhancing priorities.

Figure 1.1. **Impetus for reform has strengthened**

Responsiveness to *Going for Growth* recommendations across the OECD and the BRIICS, 2005-12



Note: See Box 1.1 for the definition of the responsiveness rate.

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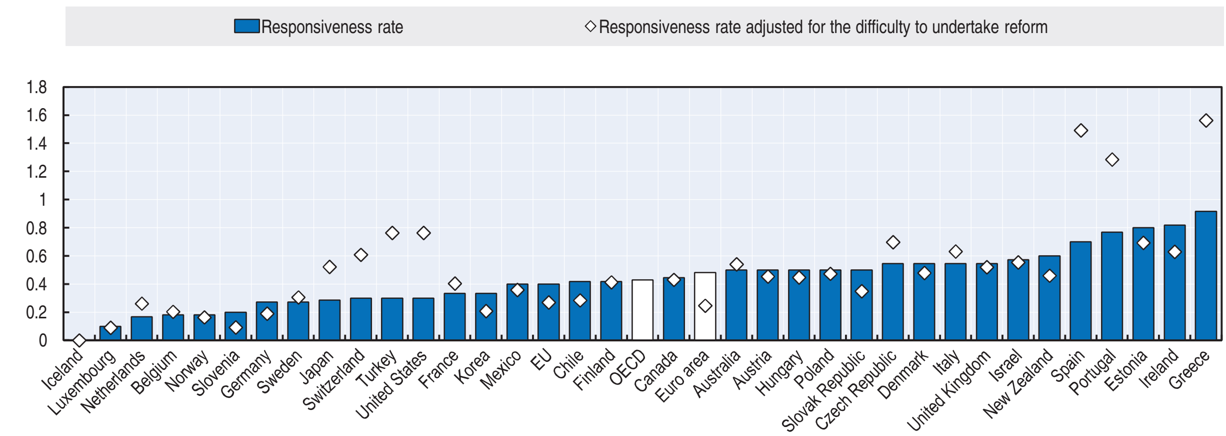
Market pressures appear to have played an important role in the intensification of reforms, as indicated by the significant correlation between reform responsiveness and changes in government bond yields over the 2011-12 period:[2]

- Euro area countries under financial assistance programmes or direct market pressures (*e.g.* Greece, Ireland, Italy, Portugal and Spain), are among the OECD countries whose responsiveness was highest (Figure 1.2, Panel A), and also where it increased most compared with the previous period (Figure 1.2, Panel B). Accession to the Euro area in 2011 – in concomitance with a steep recession – may have acted as reform catalyst for Estonia, who also ranks among the most responsive countries.
- Furthermore, as reflected in the comparison between *simple* and *adjusted* responsiveness rates, the crisis led most countries under financial markets pressure to enact reforms in traditionally politically-sensitive areas, *e.g.* labour market regulation and social welfare systems.[3]
- In contrast, less progress has been achieved in other euro area countries, in particular those with a current account surplus (*e.g.* Germany, Luxembourg and the Netherlands).[4] Yet, reforms are also needed in these countries, in particular in areas that may help intra-euro area rebalancing, such as boosting competition in non-tradable sectors.
- Despite exposure to financial market scrutiny, Iceland and Slovenia have made no or very little reform progress in the areas identified in 2011.

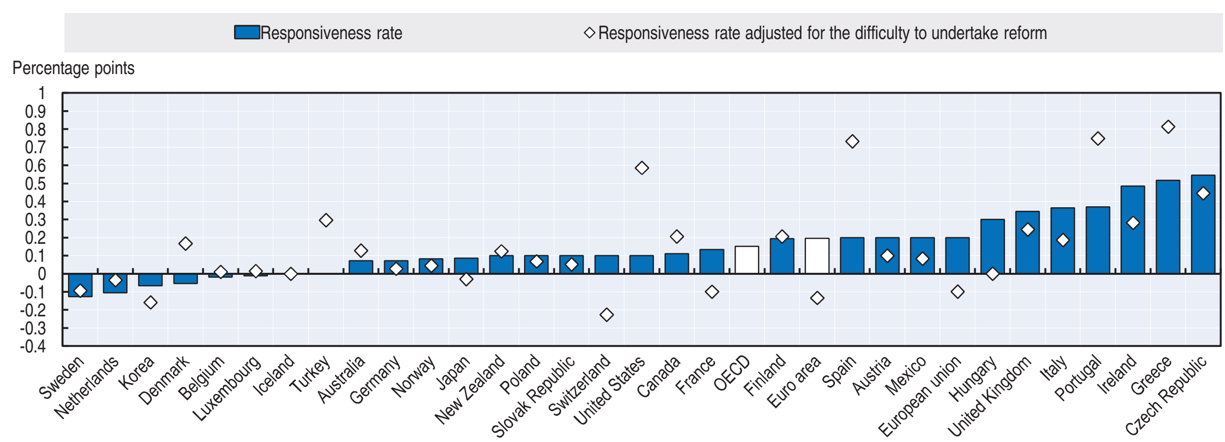
While market pressures have played a catalyst role, allowing for long-overdue reforms to be undertaken, some concerns may arise over the effects of reforms in a context of strong budgetary retrenchment and weak activity. Yet, it can be argued that some of the measures taken have already helped by boosting confidence and bringing some market relief. This may have been particularly the case of policy changes, such as pension reforms, that directly contributed to restore medium-term public debt sustainability, though reforms aimed at restoring competitiveness over time will also help to underpin confidence. Still, it is clear that the broader benefits from reforms may take more time

Figure 1.2. **The European crisis has been a major driver of reform action**

A. Responsiveness to *Going for Growth* recommendations across OECD countries, 2011-12



B. Change in responsiveness to *Going for Growth* recommendations across OECD countries from 2009-10 to 2011-12[1]



1. OECD and Euro area aggregates do not include Chile, Estonia, Israel and Slovenia. European Union refers to the country note addressed to the EU as a whole.

Note: See Box 1.1 for the definition of the responsiveness rate.

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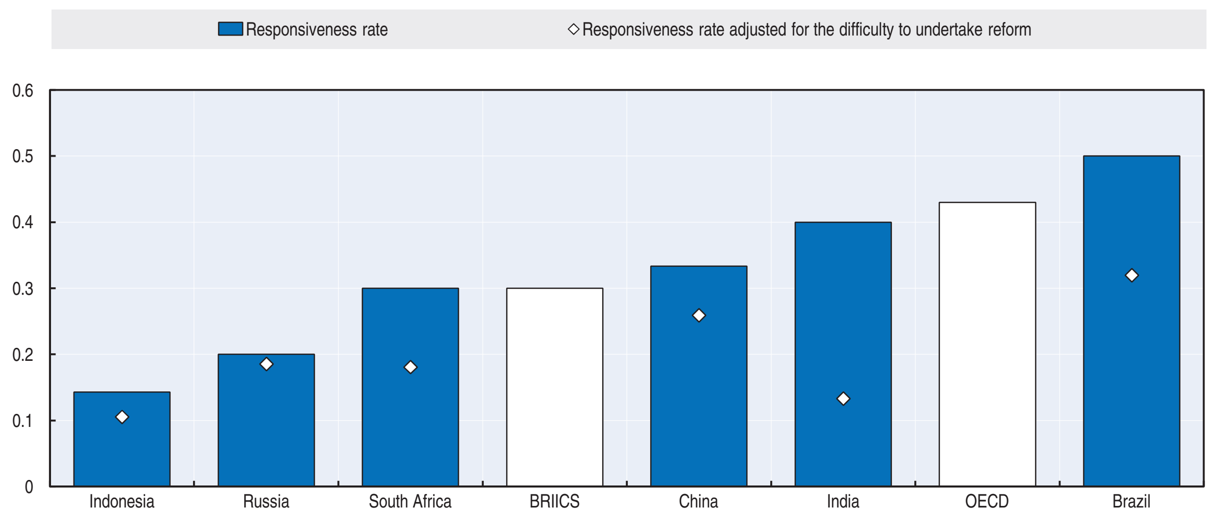
than usual to materialize in the current environment, in part due to possible delaying effects from remaining dysfunctions in financial markets. It is important to avoid such delays eroding popular support and to ensure that legislated changes be effectively implemented in order to reap the long-term gains and preserve the positive initial confidence effects.

Financial markets pressure was not the only driver of accelerated reform action. Indeed, even excluding countries under direct pressure or assistance programmes, the responsiveness rate across OECD countries remains at its highest since 2005. Still, the wealthiest countries (*e.g.* Luxembourg, Norway, Switzerland and United States) have shown moderate appetite for reform, although there has been a slight acceleration more recently in the United States (Figure 1.2, Panel B). Among the low-income OECD and BRIICS countries, where the necessity of structural reforms to achieve higher living standards is in principle the highest, reform intensity has varied:

- Central European countries (Czech Republic, Hungary, Poland and Slovak Republic), whose income gap with respect to the upper-half of OECD countries remains above 50%, have showed fairly good reform responsiveness. Progress has been more limited in Chile, Mexico and Turkey, but Mexico has of late experienced acceleration in reform action.
- Appetite for reform varied across the BRIICS but was on average comparatively lower than in the OECD since 2011 (Figure 1.1). This pattern is particularly marked in the area of labour utilisation while significant progress was achieved in the area of labour productivity. This is confirmed by comparing the *simple* and *adjusted* responsiveness rates, since the latter is systematically lower than the former in BRIICS countries, contrary to OECD countries (Figures 1.2 and 1.3).

Figure 1.3. **Reform responsiveness since 2011 has been uneven across the BRIICS**

Responsiveness to *Going for Growth* recommendations across BRIICS countries, 2011-12



Note: See Box 1.1 for the definition of the responsiveness rate.

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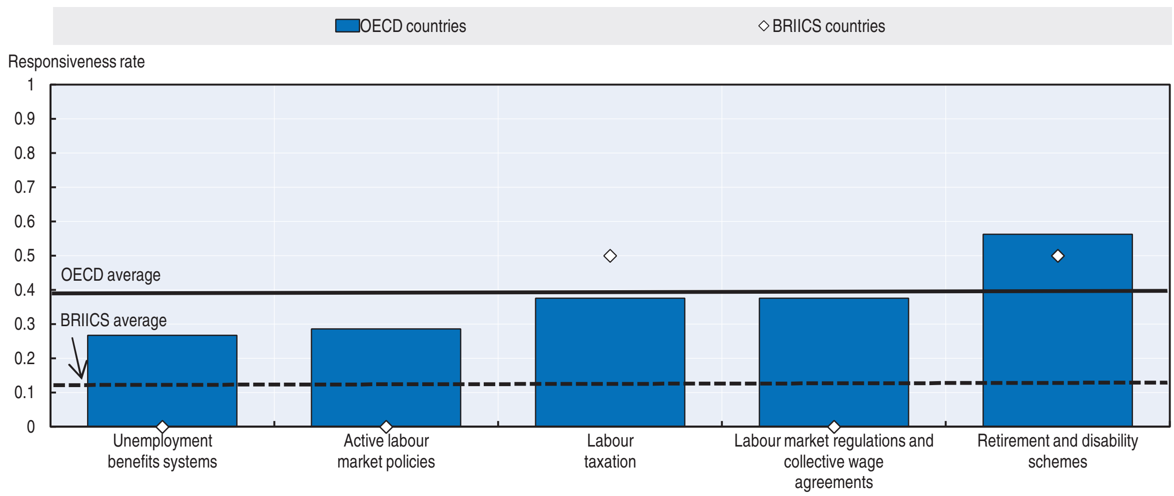
Progress in reforming policies to improve labour utilisation

Among the different labour utilisation-enhancing priorities, OECD countries have been most active in the areas of retirement and disability schemes, labour market regulations and collective wage agreements and labour taxation (Figure 1.4). Pension reforms were already on top of policy agendas at the onset of the crisis (see OECD, 2012a) and subsequently became more urgent to signal and ensure debt sustainability. Significant reforms aimed at boosting incentives to working longer were implemented in euro area countries, *e.g.* France and Spain, where this resulted in the removal of the corresponding policy priority. Labour taxation reforms have also been going on for some time now, first in response to the surge in unemployment, by *e.g.* introducing targeted reductions in social security contributions, and several countries have subsequently done so in the context of fiscal consolidation reform packages, notably by cutting labour taxes while raising taxes on consumption, property or the environment.

Figure 1.4. **Reforms to boost job creation and take-up have been more intense in some policy areas**

Responsiveness to *Going for Growth* recommendations across labour utilisation-enhancing areas, 2011-12



Note: See Box 1.1 for the definition of the responsiveness rate.

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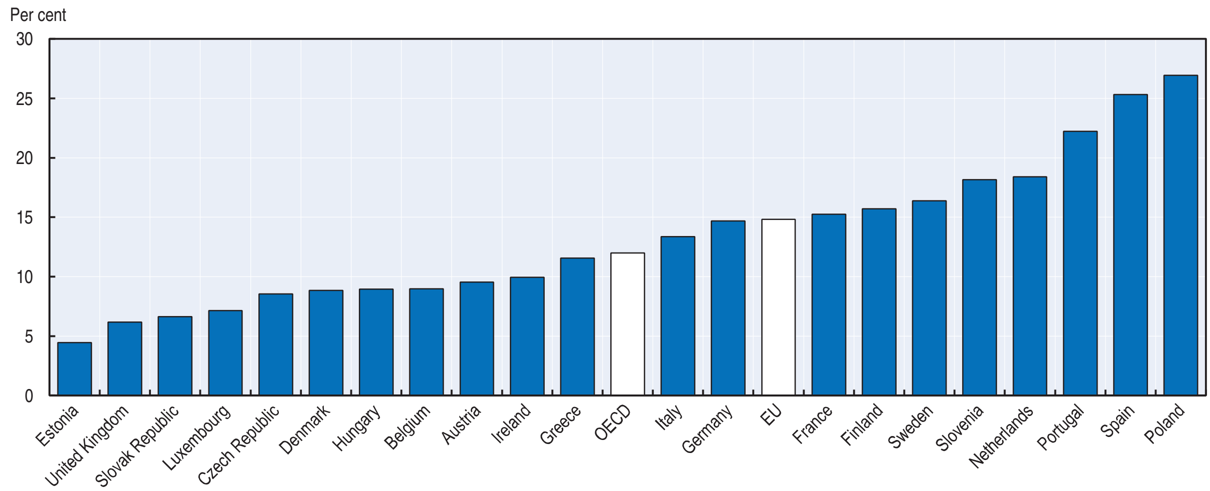
By contrast, high reform responsiveness in the area of labour market regulations and collective wage agreements is a new feature (OECD, 2012a).[5] It reflects the growing need and policy recognition to increase the responsiveness of wages to labour market pressures in order to boost growth but also to facilitate the necessary adjustment of the real exchange rate in euro area countries. Labour market regulation reforms were long advocated in a number of countries to reduce labour market duality, *i.e.* the existence of separate segments where comparable workers enjoy differential wage conditions and job protection. Such policy priorities have become even more topical in countries where the crisis highlighted major need for reallocation, for instance following downsizing of certain sectors, *e.g.* construction.

In line with recommendations, Portugal and Spain have raised the responsiveness of wage adjustments to labour market conditions by allowing firms in weak markets to deviate from collective bargaining outcomes and by reducing administrative extensions of collective agreements. Reforms in the important area of job protection were also implemented over the last two years in European countries that needed to regain competitiveness and where labour market duality is high, not least in Italy, Portugal and Spain (Figure 1.5). Progress has been notable but legislated changes were often less ambitious than initial announcements, reflecting their unpopularity and associated civil and political opposition. Further reforms in these areas are still needed and are therefore generally retained as 2013 *Going for Growth* priorities.

On the other hand, less progress has been achieved in the area of unemployment benefit systems. This likely reflects concerns to protect the incomes of the unemployed in a context where job opportunities remain dramatically low. Governments may have opted to postpone reforms until labour market conditions improve decisively. This is sensible insofar as reducing the level or duration of unemployment benefits when labour markets are depressed may result in employment losses, as suggested by empirical evidence,[6] and excessive hardship. At the same time, too generous and long-lasting benefits could prevent

Figure 1.5. **The incidence of temporary employment differs markedly across European countries**

Share of employees on fixed-term contracts in total dependent employment, 2011



Source: OECD, *Labour Force Statistics Database*.

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the return to work once the labour market recovers, requiring renewed policy focus as economic activity picks-up – at which point, though, political economy mechanisms may weaken reform opportunities. Perhaps surprisingly in view of this situation, no country opted to introduce state-contingent elements in its unemployment insurance (see below).

Reform patterns across labour utilisation and labour productivity-enhancing priorities should be interpreted with caution for the BRIICS, because the corresponding indicators rely on a very limited number of countries.[7] Bearing this caveat in mind, BRIICS countries have been most active at removing obstacles to formal labour market participation through retirement and labour taxation reforms (Figure 1.4). In Brazil, the revision of the public sector pension regime through the introduction of savings-based benefits should improve incentives for continued work. No significant progress has been achieved in other areas, typically job protection and labour market regulations, probably reflecting political-economy obstacles, combined with the absence of crisis-induced pressure to reform.

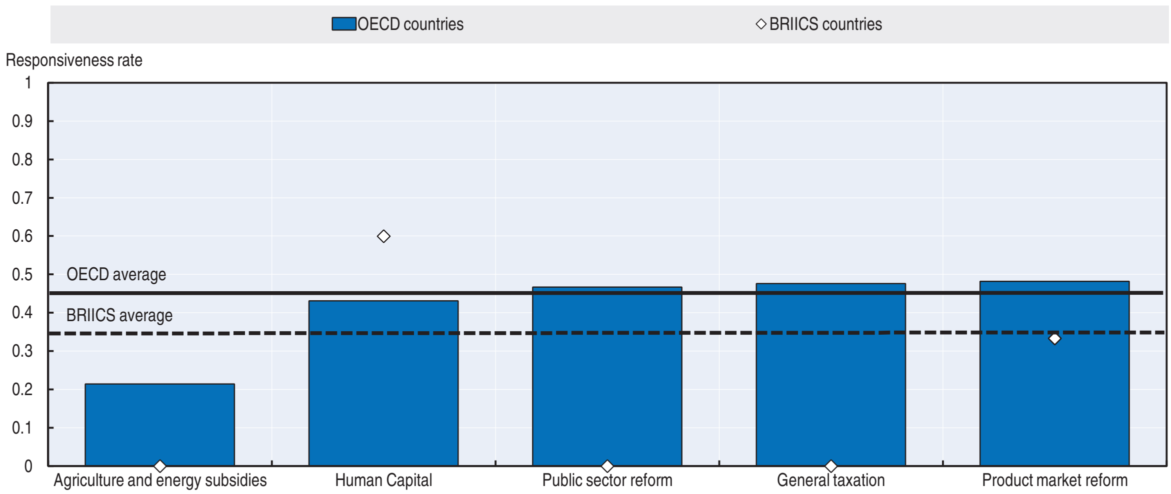
Progress in reforming policies to improve labour productivity

As found in last year's edition (OECD, 2012a), reform responsiveness has been higher on labour productivity than labour utilisation priorities in both OECD and BRIICS countries (Figure 1.6). On average, progress has been similar across major categories of labour productivity priorities except agriculture (Figure 1.6). Reform responsiveness partly reflects the growing role of growth-enhancing structural reforms implemented as part of fiscal consolidation packages:

- Tax reform has been frequent across OECD countries, with major changes taking place not only in euro area countries (*e.g.* Greece, Italy and Portugal) but also in Australia, Canada and Japan. Reform action mostly reflects the implementation of revenue-increasing and growth-friendly tax measures, *e.g.* a shift from labour to consumption, immovable property or environmental taxation (see section above).

Figure 1.6. **Reforms to boost productivity have been more evenly spread across policy areas**

Responsiveness to *Going for Growth* recommendations across labour productivity-enhancing areas, 2011-12



Note: See Box 1.1 for the definition of the responsiveness rate.

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- Against the background of budgetary pressures, most countries have followed up on their public-sector reform priorities, with a focus on improving cost-efficiency in public healthcare, given the wide scope to increase efficiency in this sector.

Fiscal consolidation imperatives were not the only drivers of policy action. In particular, some progress has been achieved on (budget-neutral) product market regulation recommendations.[8] A number of countries undertook reforms aimed at both boosting productivity and potential output but also short-term growth, *e.g.* through liberalisation of retail trade or liberal professions, as well as more broadly measures to spur competitive pressure, encourage investment and firm growth. Despite the progress achieved, actions taken in this area have rarely implied the removal of the corresponding policy priority in 2013, because major obstacles to competition remain, notably in non-tradable services but also in energy markets. Furthermore, while important actions have been achieved in a number of external deficit countries, *e.g.* Greece, Ireland, Italy and Portugal, much less has been achieved in external surplus countries where product market liberalisation is a major policy priority and could not only spur growth but also contribute to reducing current account imbalances, *e.g.* Germany, Japan and Korea.

Short-term imperatives have not constrained OECD countries' commitments to policy reform with longer-time payoffs, and reform intensity has been quite high in the area of education. Despite widespread reforms across OECD countries, corresponding priorities were not removed in 2013, since education is a fundamental driver of long-term growth and an area requiring pursued efforts over an extended period of time. By contrast, less has been achieved on agriculture and energy subsidies, confirming the political economy obstacles to reform in these areas.

All BRIICS countries that had a recommendation in the area of human capital[9] took some action to reform education (Figure 1.6). These are most welcome steps, though more needs to be done to close the wide educational gap with respect to OECD countries. The relatively high responsiveness to product market regulation priorities is an encouraging signal given the difficulty to overcome political barriers to reforms in this area. Positive steps to limit state intervention in product markets were taken in China and Brazil, including measures to encourage private-sector participation in infrastructure.

Reform priorities for OECD countries and the BRIICS

This section summarises the 2013 priorities for OECD countries and the BRIICS (based on the methodology described in Box 1.2 and Annex 1A.1). The associated country-specific recommendations are detailed in separate country notes (Chapter 3). The section begins with a brief overview of how countries rank in terms of GDP per capita and to what extent the differences in living standards can be attributed to gaps in productivity or labour utilisation. This is followed by a brief snapshot of changes in policy priorities between 2013 and 2011. The final section discusses policy priorities to enhance labour utilisation, and then those aimed at boosting labour productivity. While the dual classification of reform priorities based on their potential to raise either labour utilisation or labour productivity allows a simple and transparent assessment, it is important to keep in mind that a number of structural reforms are beneficial on *both* grounds (*e.g.* job protection and product market reforms, see Box 1.2).

Box 1.2. **The selection of policy priorities**

The *Going for Growth* methodology identifies policy recommendations based on their ability to improve long-term material living standards through higher productivity and labour utilisation. The reference performance measure in this regard is gross domestic product (GDP) per capita, given its contemporaneous availability and relatively broad coverage and despite its various drawbacks. Recognising the need to go beyond GDP per capita, *Going for Growth* is progressively integrating additional aspects of well being. As a starting point to this process, Chapter 2 covers the side effects of structural reform priorities on income distribution and the environment. Chapter 2 also examines the side effects of structural reform priorities on current account and fiscal imbalances.

Five policy priorities are identified for each country across the OECD and the BRIICS. In each case, at least three of the priorities are selected on the basis of quantitative performance and policy indicators, in areas where performance and policy weaknesses coincide. The remaining two priorities are identified using a combination of indicators, where available, and country-specific expertise (see Annex 1.A1 for a description of the process for identifying policy priorities). This is to ensure that important policy priorities in areas that are not covered by indicators are not left out. Since the set of available performance and policy indicators remains more limited for non-member countries, there is a greater reliance on country expertise for these countries.

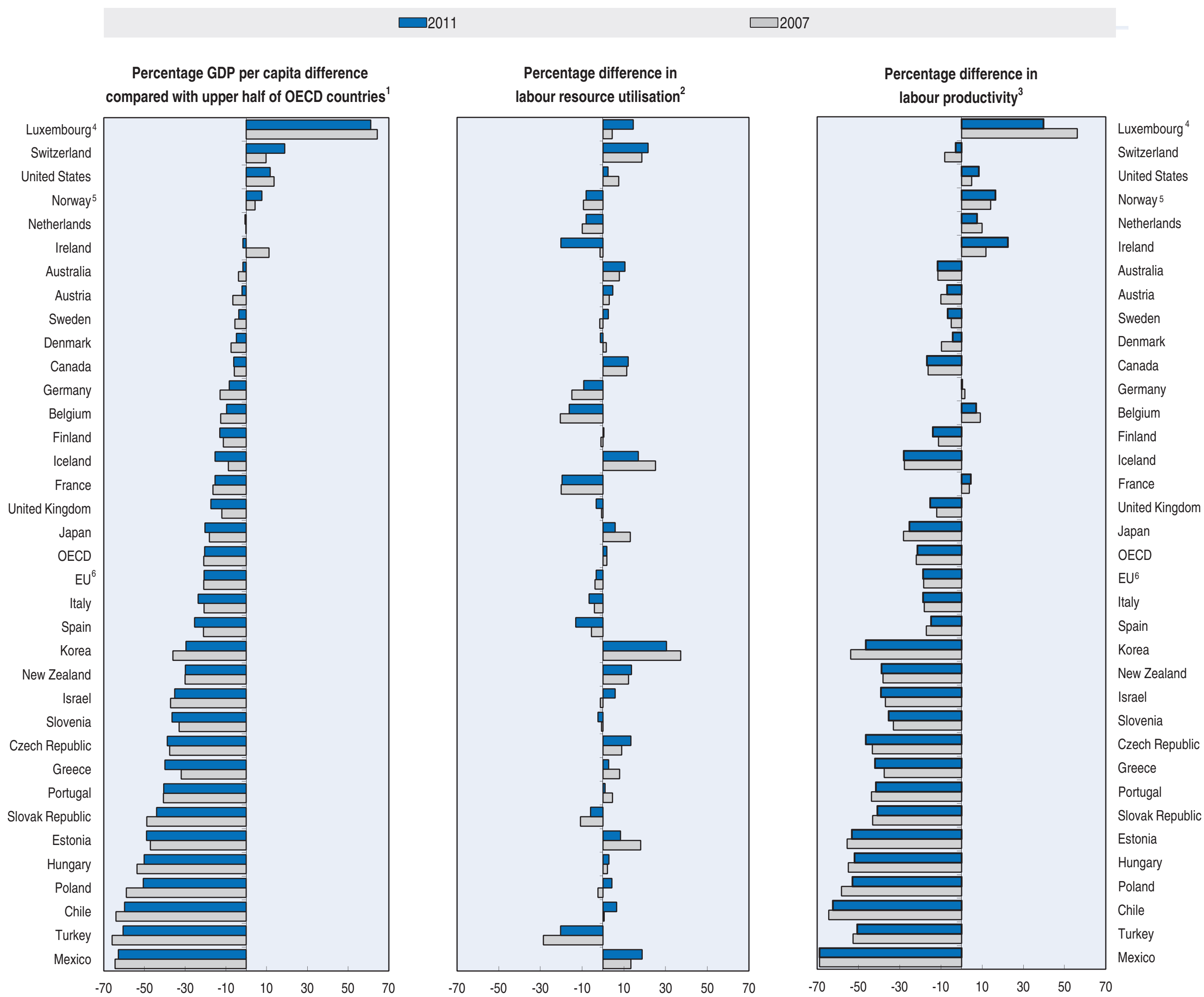
Policy priorities aimed at improving labour productivity performance include the easing of entry restrictions and controls over business operations in specific product markets, policies to boost educational outcomes, cuts in agricultural support to improve resource allocation throughout economies, and various other measures such as tax reforms and innovation policies. Policy priorities aimed at improving labour utilisation generally include reducing disincentives to work at older ages, obstacles to female labour force participation, and labour taxation, as well as improving the design of disability and sickness benefit schemes and other labour market policies such as job protection, unemployment benefits and activation policies. The mapping is not always clear cut though, as a number of policies affect *both* labour productivity and labour utilisation, *e.g.* in the areas of product market regulation and job protection.

Understanding differences in GDP per capita across countries

Gaps in GDP per capita relative to the simple average of the upper half of OECD members can be decomposed into contributions from hourly labour productivity and labour utilisation (Figure 1.7, Panel A). Cross-country patterns have remained quite stable

Figure 1.7. **Large differences in income per capita are mostly accounted for by productivity gaps**

A. OECD countries



1. Compared to the simple average of the 17 OECD countries with highest GDP per capita in 2011 and 2007, based on 2011 and 2007 purchasing power parities (PPPs). The sum of the percentage difference in labour resource utilisation and labour productivity do not add up exactly to the GDP per capita difference since the decomposition is multiplicative.
2. Labour resource utilisation is measured as the total number of hours worked per capita.
3. Labour productivity is measured as GDP per hour worked.
4. In the case of Luxembourg, the population is augmented by the number of cross-border workers in order to take into account their contribution to GDP.
5. Data refer to GDP for mainland Norway which excludes petroleum production and shipping. While total GDP overestimates the sustainable income potential, mainland GDP slightly underestimates it since returns on the financial assets held by the petroleum fund abroad are not included.
6. Average of European Union countries in the OECD.

Source: *OECD National Accounts Statistics (Database)*; OECD (2012), *OECD Economic Outlook No. 92 Statistics and Projections (Database)*; OECD, *Employment Outlook (Database)*.

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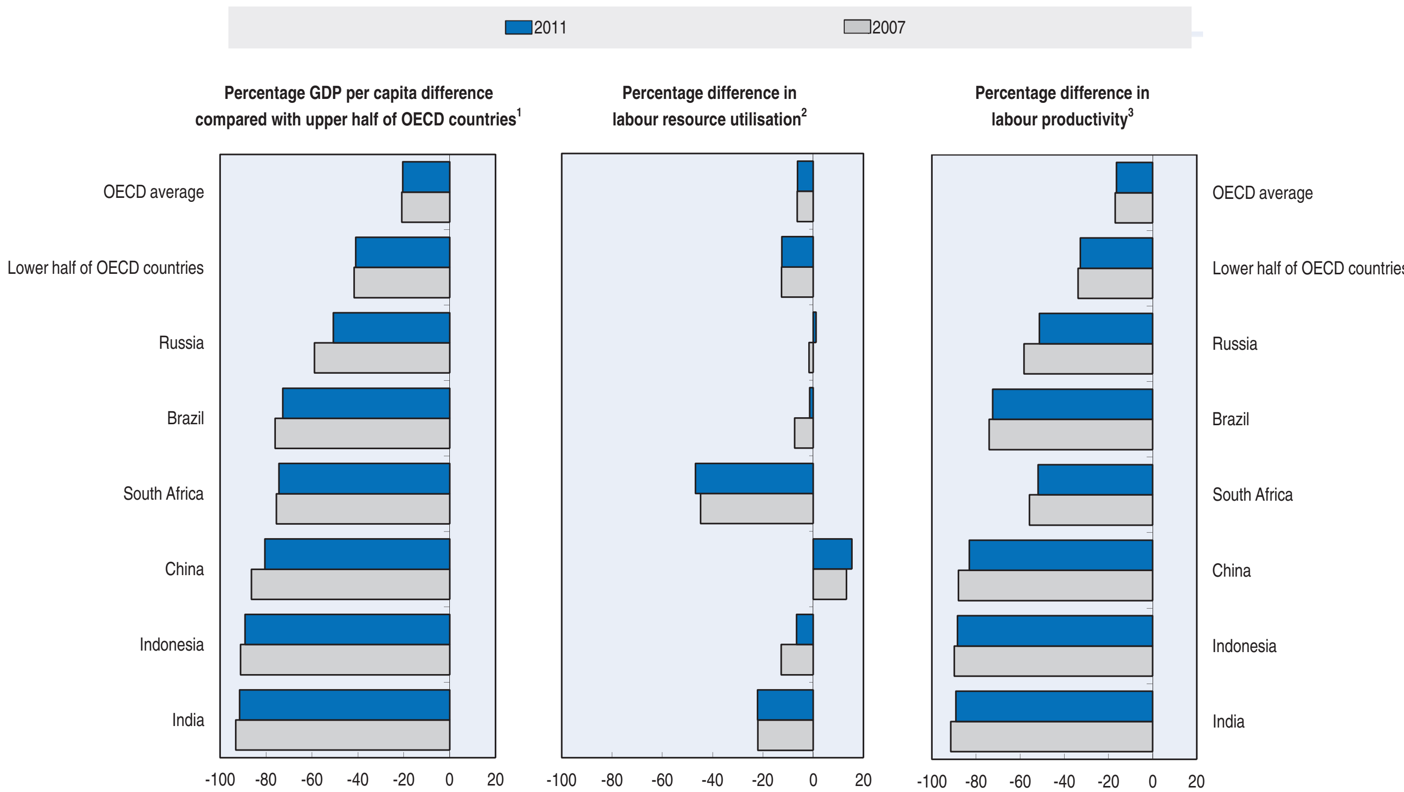
Figure 1.7. **Large differences in income per capita are mostly accounted for by productivity gaps** (*cont.*)

B. BRIICS countries *vis-à-vis* the OECD (using headcount productivity data)



1. Compared to the simple average of the highest 17 OECD countries in terms of GDP per capita in 2011 and 2007, based on 2011 and 2007 purchasing power parities (PPPs). The OECD average is based on a simple average of the 34 member countries. The sum of the percentage gap in labour resource utilisation and labour productivity does not add up exactly to the GDP per capita gap since the decomposition is multiplicative.
2. Labour resource utilisation is measured as employment as a share of population.
3. Labour productivity is measured as GDP per employee.

Source: OECD National Accounts Statistics (Database); World Bank (2012), *World Development Indicators (WDI) (Database)*; ILO (International Labour Organisation) (2012), *Key Indicators of the Labour Market (KILM) (Database)* for employment data on Brazil and Indonesia; Statistics South Africa for employment data on South Africa; India National Sample Survey (various years), annual population estimates from the Registrar General and OECD estimates for employment data on India; China Ministry of Human Resources and Social Security for employment data on China.

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despite the depth of the crisis (Figure 1.7 and OECD, 2012a). What stands out from the GDP per capita decomposition is the strong link between the cross-country dispersion of income per capita and that of labour productivity, and the absence of such link with labour utilisation.[10] The decomposition reveals different groups of countries:

- For both *top income countries* (Luxembourg, Norway, Switzerland and the United States in particular) and the dozen or so countries *with lowest GDP per capita levels*, the difference *vis-à-vis* the average of the upper half is, but to a few exceptions, accounted for by labour productivity.
- *Average income countries* can be split in several groups. In the case of many Northern euro area countries (*e.g.* Belgium, France, Germany, Ireland and the Netherlands), relatively low labour utilisation is offset by high productivity[11] while the opposite pattern is

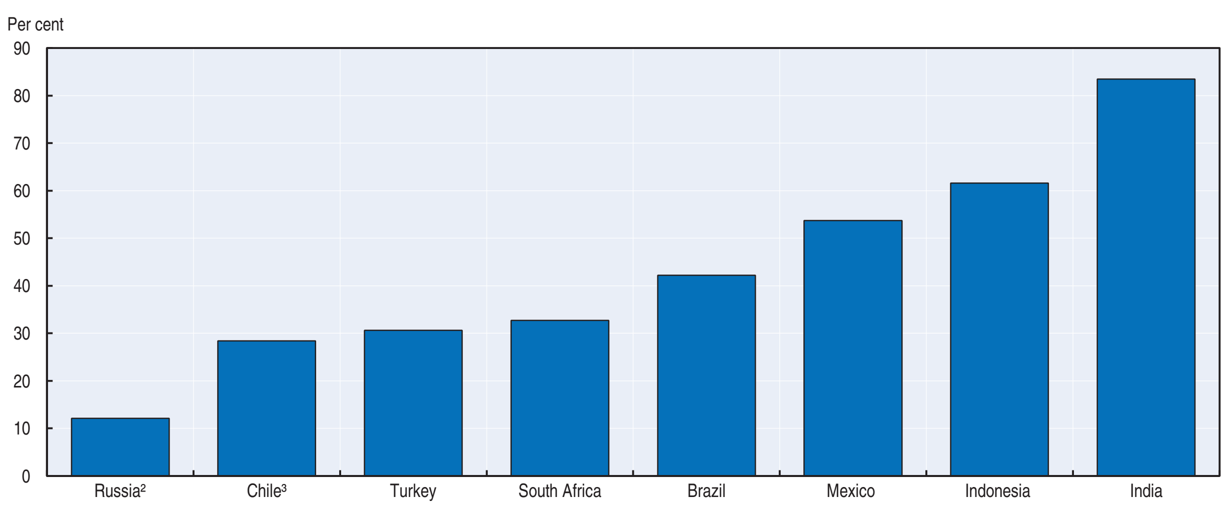
generally seen for countries outside Europe such as Australia, Canada, Japan, Korea and New Zealand. Nordic countries (other than Norway) as well as Austria and the United Kingdom have close to average levels of labour utilisation but lag behind the best performers in terms of productivity.

Despite rapid convergence in some of the BRIICS, all of them still have income gaps of between 60% and 90% to the upper half of OECD countries and continue to face large labour productivity shortfalls, even when compared with the average OECD country (Figure 1.7, Panel B). Among the BRIICS, labour resource under-utilisation is also a major challenge in India and, especially, South Africa. In contrast, labour utilisation in China is high even compared with most advanced OECD countries.

Low productivity and relatively high employment are often associated with widespread informality in the BRIICS[12] and a number of lower-income OECD countries. Although the extent of informality is difficult to measure, available data suggest that informal economic activities are particularly widespread in India and Indonesia and to a lesser, albeit still sizeable, extent in Brazil, Chile, Mexico, South Africa and Turkey (Figure 1.8). Not only emerging economies but also a number of richer OECD countries may face relatively high levels of informality, as for instance Greece, Italy and Poland.[13] Most often informality is not a choice but a fall back option, particularly in emerging countries. Informal work can play a buffer role on a cyclical basis and can be an important source of income in countries where the formal sector is still underdeveloped. However informality is associated with lower productivity[14] and also means that many workers remain outside the reach of labour market regulations and social protection schemes, often resulting in higher inequality (OECD, 2011b). Recommendations for those countries therefore include

Figure 1.8. **Informality is widespread in some emerging economies**

Share of persons in informal employment in total non-agricultural employment,[1] 2009



Note: Informal employment refers to total number of informal jobs, whether carried out in formal sector enterprises, informal sector enterprises, or households. Employment in the informal sector refers to all jobs in informal sector enterprises, or all persons who were employed in at least one informal sector enterprise, irrespective of their status in employment and whether it was their main or a secondary job.

1. Data refer to 2010 for the Russian Federation and South Africa and to 2005 for India.
2. Share of persons employed in the informal sector in total non-agricultural employment.
3. The share of self-employment in total employment is taken as a proxy for informality in the case of Chile because the most recent data on informal employment refer to the year 2000.

Source: ILO (International Labour Organisation) (2012), *Key Indicators of the Labour Market (KILM) (Database)*.

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measures aimed at boosting formal-sector activities and employment while reducing informality, *e.g.* through easing administrative barriers to the formalisation of firms, simplifying the tax system, improving revenue collection procedures, increasing the coverage of social protection systems and relaxing overly strict job protection for formal workers (see below and Country notes in Chapter 3).

A snapshot of policy priorities: 2013 versus 2011

Compared with the 2011 priorities, there has been a slight increase in the share of labour utilisation-enhancing priorities for OECD countries, especially among lower-income countries (Table 1.1). Indeed, the crisis has raised unemployment and the risk that it turns structural, hence some refocusing of priorities towards active labour market and social benefit policies aimed at softening the impact of unemployment while avoiding that it becomes entrenched. Otherwise, despite growing reform action among OECD countries as mentioned above, the vast majority of 2011 priorities are retained.[15] One reason is that structural reforms in many areas often take place gradually, with incremental policy changes introduced in sequential rounds. Indeed, in the vast majority of cases, "significant" action on policy recommendations – as defined and reflected in the reform responsiveness rate indicator presented above – has not implied the removal of the corresponding priority (Table 1.2).

The most frequent change in priorities is rather a narrowing or broadening of their scope to better reflect partial progress already made and shifts in country-specific circumstances that led to an update or reformulation of the associated policy challenges – again often dictated by the crisis context and in particular its labour market and budgetary

Table 1.1. **Share of priorities by policy area**

Per cent

Going for Growth edition	2011				2013			
	OECD	Upper-income OECD[1]	Lower-income OECD[2]	BRIICS	OECD	Upper-income OECD[1]	Lower-income OECD[2]	BRIICS
Labour productivity								
Product market regulation	26	19	30	33	22	18	24	33
Agriculture and energy subsidies	4	6	1	3	4	5	1	3
Human capital	15	12	17	17	16	13	20	17
Other policy areas	16	18	16	30	16	20	13	27
Total labour productivity	*61*	*55*	*65*	*83*	*58*	*55*	*58*	*80*
Labour utilisation								
Average and marginal taxation of labour income	7	11	5	0	7	9	5	3
Social benefits and ALMPs	17	21	13	7	22	24	22	7
Labour market regulation and collective wage agreements	11	7	14	10	10	6	14	10
Other policy areas	5	6	3	0	3	6	1	0
Total labour utilisation	*39*	*45*	*35*	*17*	*42*	*45*	*42*	*20*
Total number of priorities[3]	*175*	*85*	*85*	*30*	*175*	*85*	*85*	*30*

1. Upper-income OECD includes countries with per capita GDP levels above the median.
2. Lower-income OECD includes countries with per capita GDP levels below the median.
3. The sum of upper-income and lower-income OECD countries' priorities for doesn't add up to 175 because the EU as a whole is not counted among any of these two groups.

Source: OECD (2011), *Economic Policy Reforms 2011: Going for Growth*, OECD Publishing.

Table 1.2. **Progress on 2011 policy priorities**

	Priority areas where significant action has been taken		Priority areas where such action was sufficient to imply the removal of the corresponding priority	
	OECD	BRIICS	OECD	BRIICS
Labour productivity				
Product market regulation	24	5	6	1
Agriculture and energy subsidies	1	0	0	0
Human capital	19	3	1	0
Other policy areas	12	0	4	0
Total labour productivity	*56*	*8*	*11*	*1*
Labour utilisation				
Average and marginal taxation of labour income	4	0	1	0
Social benefits and ALMPs	18	2	4	0
Labour market regulation and collective wage agreements	8	0	2	0
Other policy areas	1	0	0	0
Total labour utilisation	*31*	*2*	*7*	*0*

implications. In the case of four countries (Italy, Japan, Mexico and the United States) two separate 2011 priorities in closely-related policy areas have been "merged" into one priority covering a somewhat broader set of recommendations. This has provided the scope for introducing a new priority for these countries.[16]

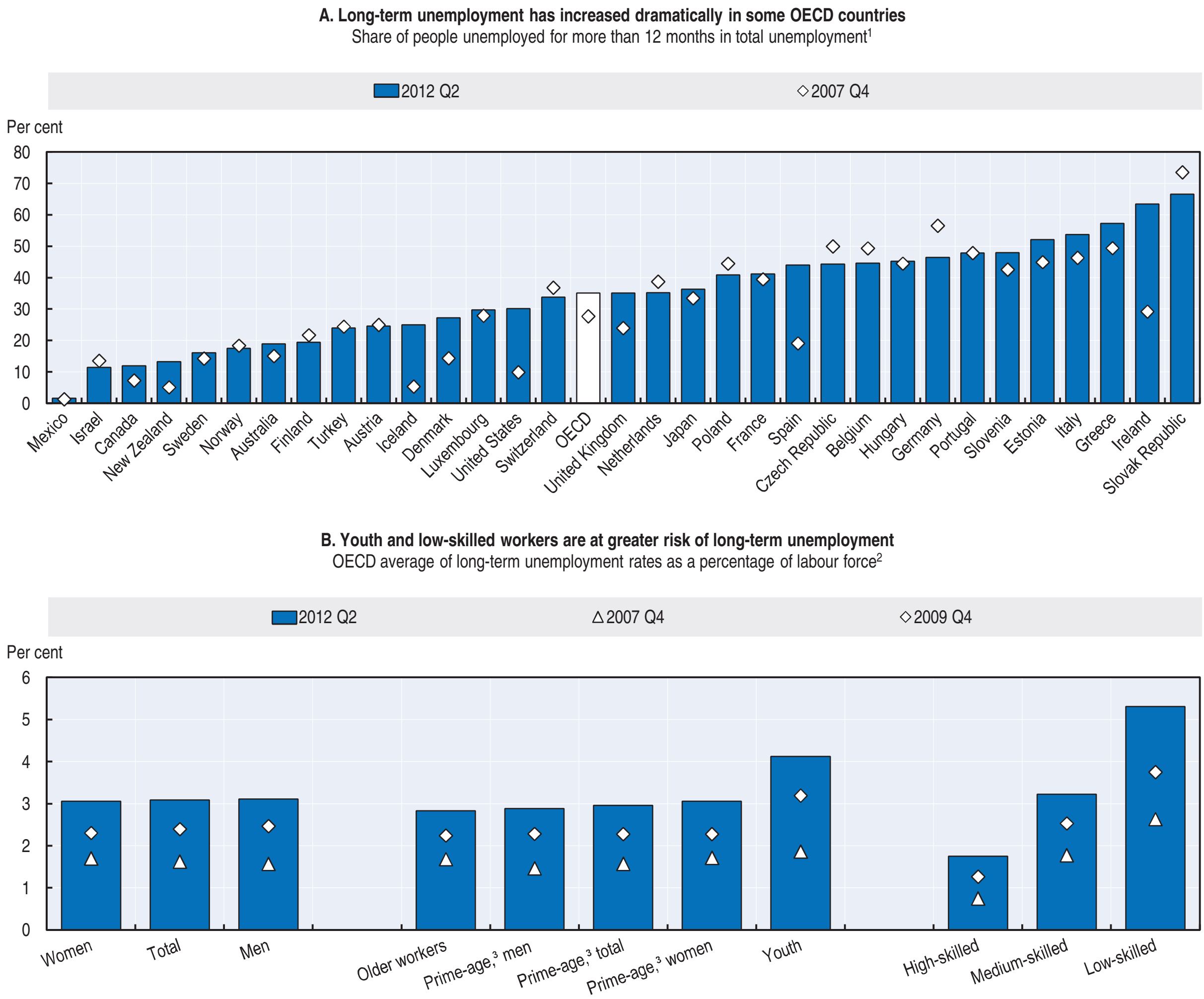
The distribution of priorities has remained remarkably stable for the BRIICS. This pattern reflects the magnitude of performance and policy gaps with respect to OECD countries, which implies that comparatively stronger action – presumably staggered over an extended period of time – is needed to justify the removal of a policy priority. To some extent, this stability also reflects the relatively mild impact of the crisis on BRIICS's labour markets compared with those of OECD countries. The bulk of priorities are aimed at improving productivity (80%, see Table 1.1), with a strong focus on product market regulation, as well as on education systems, where quality, equity and achievement levels are relatively low. Government/governance reform, strengthening institutions to fight corruption and basic financial liberalisation are also recurrent recommendations for durably boosting productivity in the BRIICS.

Policies to enhance labour utilisation

The 2008-09 global recession brought about substantial labour market deterioration everywhere, but developments in both participation and employment diverged strongly across countries (OECD, 2011a, 2011c). Together with the weak and uneven recovery in many OECD countries the implications for the labour market include:

- The absence of a vigorous and sustained recovery in aggregate demand has pushed a rising share of workers to the margin of the labour market, as witnessed by the increase in the number of long-term unemployed and discouraged jobseekers (Figure 1.9, Panel A, and OECD, 2012c):
  - ❖ Youth and low-skilled are at greater risk of long-term unemployment (Figure 1.9, Panel B), which has risen dramatically for such groups, particularly in Greece, Italy, the Slovak Republic, Spain and the United States.
  - ❖ The risk of seeing a rising share of workers losing attachment to the labour market has also showed up in the form of increased dropping-out from the labour force, which

Figure 1.9. **Long-term unemployment has been a concern since the onset of the crisis**



1. Series are smoothed using three-quarter centred moving averages. 2011q4 for Israel.
2. OECD is the weighted average of 30 countries (excluding Australia, Chile, Korea and New Zealand) for data by age and gender and of 29 countries (also excluding Japan) for data by education. Data refer to age 25-64.
3. Data refer to age 25-54.

Source: OECD (2012), *Quarterly Labour Market Indicators (Database)*, Directorate for Employment, Labour and Social Affairs unpublished data (October) and OECD estimates based on quarterly national labour force surveys, cut-off date: 7 December 2012.

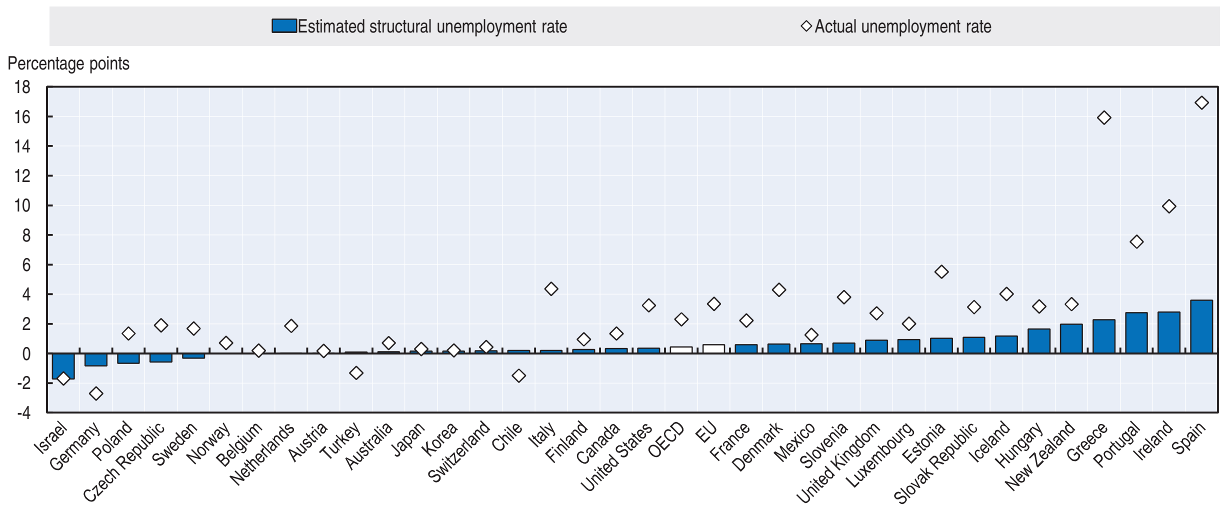
StatLink http://dx.doi.org/10.1787/888932775573

was particularly pronounced in Estonia, Ireland, Spain and the United States. Of mounting concern is the rise in the number of young persons who are neither in employment nor in education or training, the so-called "NEET", particularly so in Estonia, Ireland, Greece and Italy (Box 1.2 in Chapter 1 of OECD, 2012c).

- While there are growing concerns that the cyclical increases in unemployment may become structural over time, there is no clear evidence of this so far.[17] Bearing in mind the caveats associated with providing an accurate measure of structural unemployment, recent estimates point to a more significant increase in Spain, Ireland, Portugal and Greece, all countries hard hit by the crisis and where the increase in long-term unemployment has also generally been particularly sharp (Figure 1.9, Panel B and Figure 1.10).

Figure 1.10. **Increases in structural unemployment are widespread but uneven**

Change in percentage points between 2007 Q4 and 2012 Q2[1]



1. Change between 2007q4 and 2012q3 for Canada, Chile, Germany, Israel, Japan, Korea, Luxembourg, Norway, Spain, Sweden, the United Kingdom and the United States.

Source: OECD, *OECD Economic Outlook No. 92: Statistics and Projections (Database)*.

StatLink http://dx.doi.org/10.1787/888932775592

Going for Growth priorities are mainly aimed at raising labour utilisation over the long-term, but many would also help alleviate the labour market effects of the crisis and boost competitiveness, *e.g.* well-designed active labour market policies could reduce unemployment persistence and encourage the return to work while increasing the responsiveness of wages to labour market pressures would encourage rebalancing and euro area real exchange rate adjustment. More generally, addressing these concerns calls for action in several policy domains, spanning taxation, social benefits and activation policies, labour market regulation and wage bargaining arrangements. Table 1.3 provides a synthetic summary of main labour utilisation-enhancing recommendations across OECD and BRIICS countries.

Average and marginal taxation of labour income

High average and – in particular – marginal taxes on labour incomes can reduce workforce participation and raise unemployment, especially for workers with low incomes. Despite some action taken on nearly 40% of previous priorities in this area, lowering such taxes (including through cuts in social security contributions) is a priority for more than half of OECD countries (Table 1.3). Reductions in labour taxes are often recommended as part of policy actions aimed at reducing labour supply distortions sometimes embedded in the overall tax and benefit system, especially for specific groups of the labour force, *e.g.* low earners and second earners or lone parents.

Given the substantial fiscal consolidation challenges that many countries face, efforts in that direction can only be pursued gradually and with the reductions funded by expenditure cuts, base broadening, as well as through shifts in the structure of taxation more towards growth-friendly forms of taxation, such as taxes on consumption, immovable property or pollution emissions. Reductions in labour taxes are therefore generally recommended within broader revenue-neutral or revenue-raising policy packages aimed at improving the efficiency of taxation (see below), and/or in association with measures to generate public spending efficiency gains. Outside OECD countries, labour taxes are generally lower and thus pose less of a disincentive to work, with the exception of Brazil where reducing them is seen as a priority.

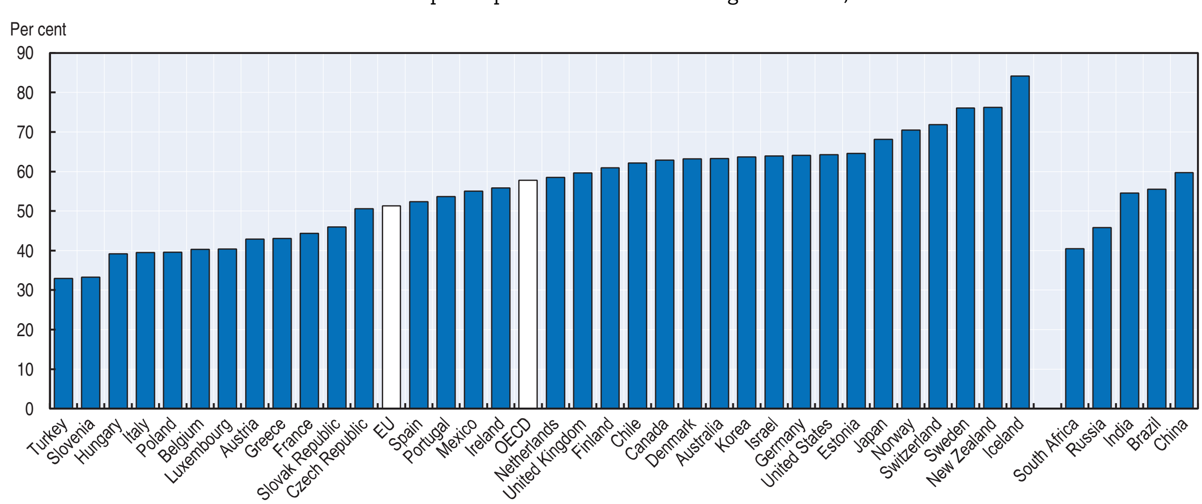
Social benefits and active labour market policies

Retirement and disability schemes. One notable feature of this crisis has been that employment rates of older workers have held up surprisingly well, in contrast with previous recessions where premature labour market withdrawal was often encouraged by early retirement incentives (OECD, 2011d). To some extent, the current trend reflects the benefits of earlier reforms that have resulted in the closing of many pathways to early retirement (see OECD, 2012a). More recently, in the context of fiscal consolidation (see previous section), significant reforms took place in this area, *e.g.* in France and Spain reforms have included increases in retirement age and in contribution periods required for a full pension. Still, given that less severe recessions have in the past led to significant labour market withdrawal with a notable lag (Duval *et al.*, 2011), further reductions of financial disincentives to continued work are still being recommended across OECD and BRIICS countries (Table 1.3). In the short run, reforms in this area may help ensure that laid-off older workers remain attached to the labour market. Over the longer term, such reforms will allow raising older workers' participation rates, which are currently very low in some countries (Figure 1.11).

Linking pensions to life expectancy can be seen as a partial substitute for *discretionary* increases in pension ages in ensuring retirement-income provision is financially sustainable. *Automatic* links between pensions and life expectancy are now in place in at least 20 of the 34 OECD countries. However, countries have overwhelmingly chosen to link benefit levels to life expectancy rather than pension ages – as only five of them have life-expectancy links in their mandatory pension system. On balance, a link between pension age and life expectancy, rather than benefit levels is a preferable option (see Chapter 5 in

Figure 1.11. **Raising senior labour market participation remains a challenge for many countries**

Labour force participation rate of workers aged 55 to 64, 2011[1]



1. The last available year is 2009 for Brazil and 2010 for China and India.

Source: OECD, *Labour Force Statistics Database*.

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Table 1.3. **Labour utilisation-enhancing reform recommendations in OECD and BRIICS countries**

	Australia	Austria	Belgium	Canada	Chile	Czech Republic	Denmark	Estonia	European Union	Finland	France	Germany	Greece	Hungary	Iceland	Ireland	Israel	Italy	Japan	Korea	Luxembourg
Retirement and disability policies																					
Phase out early retirement schemes		✔	✔							✔				✔							✔
Increase statutory or minimum retirement age			✔							✔											
Lengthen contribution requirements to claim full pension/ make benefits actuarially neutral										✔											✔
Adjust benefits/retirement age in line with life expectancy														✔							✔
Review criteria to disability benefits, improve monitoring		✔					✔	✔													
Unemployment benefits, ALMPs, social protection																					
Reduce replacement rates over the unemployment spell/ reduce benefit duration			✔							✔	✔										✔
Expand the coverage/generosity of social safety nets, unemployment benefits					✔													✔	✔	✔	
Strengthen ALMPs			✔					✔		✔	✔		✔			✔	✔	✔			✔
Labour taxation																					
Reduce average or marginal labour taxation		✔	✔	✔			✔	✔		✔	✔	✔		✔				✔			
Remove tax and benefit disincentives to full-time female/ second earners/lone parents participation						✔						✔							✔		
Remove tax and benefit disincentives to low earners participation		✔	✔			✔		✔									✔				
Labour market regulation and institutions																					
Reform job protection legislation to reduce duality											✔	✔						✔	✔	✔	✔
Reduce the minimum cost of labour											✔						✔				
Reform wage bargaining to raise wage responsiveness to labour market conditions			✔																		
Strengthen public support for childcare and pre-school education and reform parental leave policies	✔				✔	✔						✔				✔			✔	✔	

Table 1.3. **Labour utilisation-enhancing reform recommendations in OECD and BRIICS countries** (*cont.*)

	Mexico	Netherlands	New Zealand	Norway	Poland	Portugal	Slovak Republic	Slovenia	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States	Brazil	China	India	Indonesia	Russian Federation	South Africa
Retirement and disability policies																				
Phase out early retirement schemes					✔			✔				✔			✔					
Increase statutory or minimum retirement age								✔				✔								
Lengthen contribution requirements to claim full pension/make benefits actuarially neutral								✔				✔								
Adjust benefits/retirement age in line with life expectancy																				
Review criteria to disability benefits, improve monitoring		✔		✔	✔					✔			✔	✔						
Unemployment benefits, ALMPs, social protection																				
Reduce replacement rates over the unemployment spell/reduce benefit duration		✔				✔														
Expand the coverage/generosity of social safety nets, unemployment benefits												✔						✔		
Strengthen ALMPs						✔	✔		✔					✔						✔
Labour taxation																				
Reduce average or marginal labour taxation		✔			✔					✔										
Remove tax and benefit disincentives to full-time female/second earners/lone parents participation		✔					✔				✔		✔							
Remove tax and benefit disincentives to low earners participation												✔			✔					
Labour market regulation and institutions																				
Reform job protection legislation to reduce duality	✔	✔				✔		✔	✔	✔		✔					✔	✔		
Reduce the minimum cost of labour												✔						✔		✔
Reform wage bargaining to raise wage responsiveness to labour market conditions						✔		✔	✔											✔
Strengthen public support for childcare and pre-school education and reform parental leave policies					✔		✔				✔	✔	✔							

OECD, 2011d). Indeed, benefit cuts may push low-income retirees onto social assistance and other safety-net programmes, at the risk of offsetting some or all the savings achieved through linking public-pension benefits to life expectancy. It will also put additional burden on private defined contribution plans. Linking both pension ages and benefits with life expectancy is, however, a potentially attractive option to ensure financial stability, improved incentives to working longer and income adequacy at older ages (see OECD, 2011d).[18]

Likewise, a tightening of some early exit routes from the labour market risks triggering an increase in the use of others. In particular, disability and sickness benefits are needed to ensure appropriate incomes to individuals whose health status temporarily or permanently prevents them from working or searching for jobs, but these schemes are sometimes misused and poorly targeted. Moreover, persistently high unemployment is adding renewed pressure on systems that do not enforce strict health criteria for eligibility and are insufficiently monitored. Better monitoring of eligibility for and tightening of access to disability schemes are identified as priorities for Austria, the Netherlands, Norway, Poland and the United States – in the latter country enhanced workplace accommodation and rehabilitation services are also necessary. More frequent reviews of individual work capacity are a priority in the Netherlands, Norway and the United Kingdom. Denmark is being recommended to closely monitor the effects of the *Fleksjob* reforms and move towards regular entitlement assessments and Estonia to open activation measures to disability recipients and strengthen the role of employers in prevention and rehabilitation measures. Sweden undertook a substantial reform of its sickness and disability pension schemes and priority should be given to monitor its impact.

Unemployment benefit (UB) and social protection systems. Restructuring unemployment benefit systems is a particular challenge in the post-recession context due to the heightened risk of unemployment persistence and early withdrawal from the labour force. Unemployment benefit systems have been an important device for mitigating the income losses caused by the crisis, reflecting concerns to protect the incomes of the unemployed and avoid excessive hardship (see above and OECD, 2012a). Some countries have for instance extended the coverage of unemployment benefits to workers previously not covered, raised the level or lengthened the duration of benefits, especially where these were comparatively low or short. However, too-high or long-lasting unemployment benefits reduce job-search incentives and may push wages up, thereby potentially increasing structural unemployment (for recent evidence, see de Serres *et al.*, 2012). Unemployment insurance reform or, more broadly, reform of social protection aimed at improving work incentives are identified as priorities in Belgium, Finland, France, Luxembourg, the Netherlands and Portugal (Table 1.3). In these countries, stricter limits on benefit duration or a reduction in their level over the unemployment spell are typically recommended, although implementation should take place only once labour market conditions have sufficiently improved.

Although not part of the priorities identified, there is rationale for extending benefit duration during recessionary periods when unemployment spells typically are longer, such that benefit exhaustion rates remain roughly in line with the rates observed during non-recessionary times, especially for programmes with short durations, and then returning to normal duration limits as the labour market recovers. Canada, Iceland, Israel[19] and the

United States provide recent examples of adjusting the UB programme parameters in response to changing labour market conditions. For example, in the United States, under the extended benefits programme, some states have laws that automatically extend the unemployment insurance benefit duration when the unemployment rate is above a certain level (OECD, 2011c). Similarly to state-contingent unemployment benefit duration, short-time working schemes (STW) may provide a useful buffer that can be activated depending on the economic situation and several OECD countries have introduced STW schemes as a response to the 2008 crisis. Although an empirical assessment of the long-term effects of STW schemes is not yet available, the crisis experience – and in particular the German example – suggests that having such options in place and being able to activate them in severe downturns can be useful, insofar as they may avoid losses of specific human capital in the wake of shocks that are temporary and do not imply a need for reallocation (Hijzen and Venn, 2011). By contrast, when shocks imply a need for reallocation across sectors, STW schemes may hinder labour reallocation and thus limit employment variability over the cycle at the expense of productivity in the long run.[20]

In contrast to increases in levels of benefit duration, some of the extensions in the coverage of unemployment benefits from previously low rates should be made permanent provided they are coupled with conditionality and activation measures. Indeed, a number of OECD countries fail to ensure an appropriate coverage of unemployment benefits, often due to strict entitlement conditions (*e.g.* associated with employment and contribution records and sanctions for voluntary unemployment).[21] Incomplete coverage is a particular concern in countries characterised by labour market duality, where a substantial proportion of the workforce (those on fixed-term contracts) is often not covered by the system. Yet low coverage raises not only equity and exclusion concerns but also the risk of labour market withdrawal and discouragement effects, possibly hampering return to work and efficient job search. Reforms to expand the coverage or generosity of social safety nets and in particular unemployment benefit systems are recommended for Italy, Japan and Korea (Table 1.3), in association with job protection and active labour market policies aimed at reducing duality. Such reforms are also of mounting importance in emerging economies and the BRIICS where welfare systems are comparatively underdeveloped and contribute to labour informality (*e.g.* in Chile, Indonesia and Turkey). China is advised to reduce barriers to mobility and enable internal labour reallocation, *e.g.* by enhanced provision of social rights and public services to migrants.

Active labour market policies. OECD countries have been increasingly endorsing the need to develop sound active labour market policies (ALMP) to strengthen jobseekers' attachment to the labour market and, in association with well-designed unemployment benefit systems, encourage the return to work. In the wake of the crisis, more than two-thirds of OECD countries boosted resources for job-search assistance and training programmes in order to facilitate re-employment and re-deployment (OECD, 2012a). The weak and uneven recovery in many OECD countries raises the importance of using these resources most effectively so as to facilitate the return to work and reduce the risk that the cyclical increase in unemployment becomes structural (Figure 1.10).

Active labour market and training policies are identified as new priorities for two groups of countries: *i)* countries that have experienced construction and housing bubble bursts (*e.g.* Ireland, Spain and the United States) and where policies should focus on addressing skill mismatches by encouraging requalification; and *ii)* countries that are experiencing a pronounced and persistent surge in unemployment, especially among youth (*e.g.* Greece and Italy), and which should focus on preventing discouragement effects. All these countries also feature either a sharp rise in long-term unemployment, in the estimated structural unemployment, or in the proportion of NEET (see above). Stepping-up the level and efficiency of ALMPs is reiterated for Belgium, Estonia, Finland, France, Ireland, Israel, Luxembourg, the Slovak Republic and South Africa (Table 1.3).

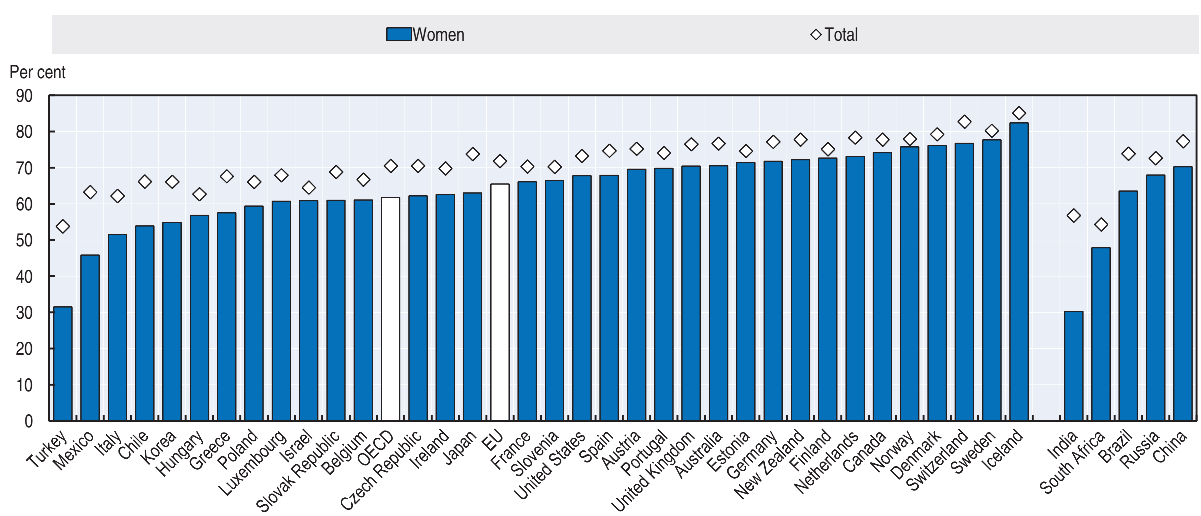
Policy barriers to full-time female participation. A high proportion of women are largely excluded from the labour market in a number of countries (Figure 1.12) while in others they are overrepresented among (involuntary) part-time workers. Recommendations are made to encourage female labour force participation or hours worked where those are particularly low. Beyond disincentives embedded in the level and design of taxes and benefits along with stringent job protection regulations, improving access to childcare and reforming parental leave policies would facilitate the integration of women in the labour market (Jaumotte, 2004). Strengthening childcare programmes and related policies is a priority for more than a third of OECD countries (see Table 1.3).

Labour market regulations and collective wage agreements

Reforming labour market regulations and collective wage agreements would not only help employment to pick-up but also reduce unemployment persistence in countries where the jobless rate is high. Reforms in these areas could also reduce labour market duality (Figure 1.5) for instance in parts of Europe (*e.g.* in France, Italy, Spain and Portugal).

Figure 1.12. **Labour utilisation is held back by low female participation in a number of countries**

Labour force participation rate, 2011[1]



1. Aged 15-64. The last available year is 2009 for Brazil and 2010 for China and India.
Source: OECD, *Labour Force Statistics Database*.

StatLink http://dx.doi.org/10.1787/888932775630

Job protection. Firing restrictions have cushioned unemployment during the crisis, but an excessive gap in protection between permanent and temporary contracts is one of the main institutional features contributing to duality in the labour market. Duality leads to labour and capital misallocation as well as to underinvestment in training for temporary workers, hence ultimately to lower productivity (Bassanini *et al.*, 2009; Cingano *et al.,* 2010; Lepage *et al.,* 2012; Bentolila *et al.,* 2012; Blanchard and Landier, 2002). The costs of duality are high: excess employment volatility, reduced access to stable jobs, recurrent spells of temporary jobs, and long and frequent unemployment spells among "marginal workers" under temporary or atypical contracts, essentially youth. All these factors undermine the career prospects of workers on temporary contracts and hence contribute to the entrenchment of duality.

Despite progress achieved in this area over the last two years – in particular in European countries affected by the sovereign debt crisis (c.f. OECD, 2012a, and above) – further reforms to rebalance job protection between permanent and temporary contracts are needed in France, Germany, Japan, Korea, Luxembourg, the Netherlands, Portugal, Spain, Slovenia, and Sweden. In Italy, the parliament has recently approved an important labour market reform which should help reduce duality and priority must now be given to reducing judicial delays in labour settlements, a recommendation also advanced for Mexico and Portugal. Job protection reforms are also encouraged in emerging economies (India, Indonesia, Mexico and Turkey) to tackle the problem of informality which can be considered as an extreme form of duality.

The idea of introducing a single labour contract so as to achieve job protection convergence between different types of workers has been advocated by prominent academics but controversies remain about its practical implementation, including legal and political economy obstacles.[22] Austria may provide a model of *de facto* convergence, under which unpredictable dismissal costs for employers are converted into a system of individual savings accounts, funded from a set of employers' contributions from the first day of employment until contract termination. This separation allowance can be cumulated by the employee over an entire working life, and does not harm job mobility given that workers do not lose their entitlements to severance payments when quitting to take a new job. One of the key advantages of the system – which can be thought of as a form of mandatory savings – is to offer workers severance payments that rise gradually with tenure while reducing uncertainty as regards dismissal costs faced by employers.[23] The latter feature should encourage hiring on regular rather than temporary contracts and ultimately reduce labour market duality.

Minimum wages and wage bargaining systems. Set at a moderate level, and implemented in a flexible manner (*e.g.* differentiated rates across regions or between youth and prime-age workers), a statutory minimum wage can encourage the labour force participation of low-skilled workers, especially if combined with in-work benefits. However, overly high minimum labour costs, which can result from a combination of legal minimum wages and labour taxes, can limit the jobs available for young workers and the low-skilled.[24] Reductions in the relative level or growth rate of minimum wages *vis-à-vis* median wages are recommended as a means to encourage low-skilled and formal employment in both some OECD and large emerging-market countries where the minimum wage appears to weigh on (formal) employment (France, Indonesia, Israel, Slovenia and Turkey). In South Africa priority should be given to introducing age-differentiated minimum wages in sectors where these are not set by collective bargaining.

The cost of labour can also be driven to levels that are detrimental to employment by collective wage agreements that in some countries are administratively extended to workers and employers who are not party to the original negotiations and settlements (and who may sometimes be in different sectors and regions). Reforms in this area are being recommended for Belgium, Portugal, Slovenia, South Africa and Spain in order to better align wages with productivity conditions at aggregate, regional, firm and skill-specific levels.

Housing policies

Housing policies can affect both labour productivity and labour utilisation.[25] Restrictive housing policies such as strict rent regulation can hamper housing investment and supply, limit labour mobility and potentially raise structural unemployment, especially in the current recovery context where reallocation of labour across different sectors and regions is needed in a number of OECD countries. Overly stringent planning and zoning can raise house price levels and volatility, and thereby contribute to financial and economic instability as well as undermine competition and productivity in certain sectors such as retail trade (see special Chapter 4 in *Going for Growth* 2011; OECD, 2011a). Housing policies and rent regulation need to be revised in Denmark, Israel, Luxembourg, the Netherlands, Poland, Slovak Republic, Sweden and the United Kingdom.

Policies to enhance labour productivity

The likely permanent GDP loss from the 2008-09 recession – estimated at some 3% for the OECD on average (OECD, 2009) – is driven by lower potential employment, but also by lower capital accumulation resulting from the long-lasting elevation of risk *premia* and the cost of capital usually observed in the aftermath of a financial crisis. This in turn may hamper investment in both tangible and intangible assets – including innovation activity – hence ultimately productivity.[26] Also worryingly for future productivity developments, the recent crisis seems to have raised pressures for adopting protectionist measures and there may be some evidence that various subtle barriers to cross-border trade are being set-up.[27]

At the same time, the crisis also provides opportunities to boost long-term productivity through reallocation effects, *i.e.* by shifting resources away from inefficient sectors towards more productive ones. Such transition is by nature protracted, but public policies can help accelerate the reallocation and set the conditions for faster medium-term growth with reforms in the areas of product market regulation, general taxation as well as the efficient provision of public services and infrastructure. Achieving the highest degree of efficiency in the delivery of public services is all the more important in the current budgetary environment.

Policy priorities aimed at improving productivity performance are mainly concentrated on countries with a large productivity gap *vis-a-vis* the best performers (Figure 1.7) or weak productivity growth. Economy-wide convergence in productivity levels has been unevenly distributed across OECD countries over the last decade (Figure 1.13), with stronger convergence observed in Central European countries, Estonia and Turkey as opposed to *e.g.* Greece, Japan, Mexico and New Zealand. Among the BRIICS, convergence has been strongest for China, India and Russia, while it has been weakest for Brazil and South Africa. As noted already, despite the progress achieved, productivity levels in the

BRIICS remain far below OECD average and explain the bulk of their income gap *vis-à-vis* OECD countries (Figure 1.7).

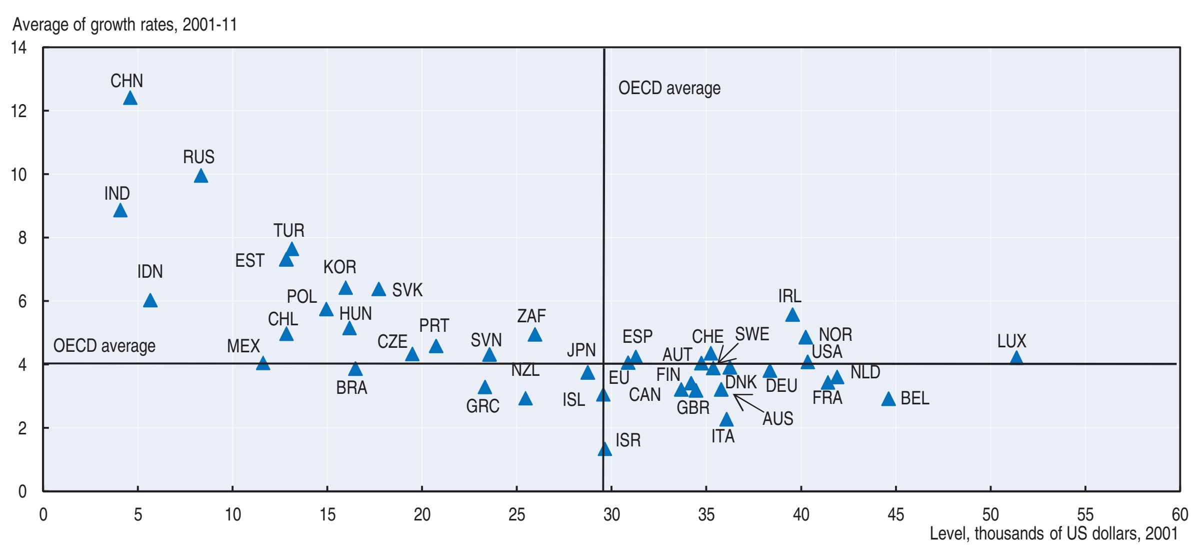
Product market reforms

A broad range of firm, industry and macro-level evidence illustrate the impact of product market regulation on the pace of convergence in productivity levels to technologically advanced economies.[28] Product market regulation can also affect aggregate productivity through its impact on the capacity of the economy to allocate capital and labour resources to fast-growing sectors. Estimates of the potential impacts of product market reform point to a strong pay-off, with the long-term gains in living standards realised relatively rapidly (see Bourlès *et al.*, 2010, on OECD countries; Bas and Causa, 2012, for recent evidence on China).

Against the background of large productivity gaps despite rapid convergence (Figure 1.13), all of the BRIICS have at least one product market reform priority and even two for many of them.[29] Moreover, a number of such reforms are targeted at network and infrastructure sectors where lower-income countries face substantial shortages. Such recommendations are therefore often formulated in association with increases in infrastructure provision. Despite encouraging progress over the recent period (see above), product market reforms remain a priority for many OECD countries – in particular in Europe. At the current juncture they could facilitate adjustments in unit labour costs and the reallocation of resources across firms, as well as boost short-term growth and jobs creation (see Bouis *et al.*, 2012). Stronger competition and lower barriers to entry would help ensure that recent wage reductions result in greater job creation. Hence, product market reforms are not only important *per se*, but also as a necessary complement to labour market reforms.[30] By lifting productivity and potential growth, pursuing such reforms

Figure 1.13. **There has been uneven convergence in productivity levels over the last decade**[1]

Average productivity growth over the past decade against the initial level



1. Labour productivity is measured as GDP per hour worked for OECD countries and Russia and as GDP per employee for the remaining BRIICS.

Source: *OECD National Accounts Statistics (Database)*; OECD (2012), *OECD Economic Outlook No. 92: Statistics and Projections (Database)*; OECD, *Employment Outlook (Database)*.

StatLink http://dx.doi.org/10.1787/888932775649

would have beneficial effects on debt dynamics and fiscal sustainability in euro area peripheral countries. Rebalancing across the euro area requires reforms to be undertaken in *both* core and non-core countries. Product market reforms – in particular encouraging competition in non-tradable sectors – are also needed in euro area core countries, where appetite for reform has stalled over recent years.

Table 1.4 summarises policy recommendations in the area of product markets for OECD and BRIICS countries. For the majority of countries, recommendations are made to reduce economy-wide regulatory burdens, *e.g.* by lifting barriers to firm entry and exit, improving the transparency of regulation and strengthening competition frameworks. Reducing the scope of public ownership is specifically advocated for some countries where state intervention is particularly widespread, with evidence that this hurts efficiency. Not only economy-wide but also sector-specific administrative burdens are still a problem in many countries, and most countries are advised to further reduce sector-specific barriers to competition, *e.g.* in network industries, retail trade and professional services. Evidence suggests that aside from the boost to productivity, reducing barriers to entry in the latter sectors can generate fairly rapid employment gains (OECD, 2012a). Finally, in a more limited number of OECD and BRIICS countries, barriers to foreign investment and international trade remain stringent and may hamper catch-up and productivity growth. Recommendations in this area cover both specific sectors where restrictions are a particular concern or more broadly the transparency of screening procedures.

Human capital

Reforms that facilitate the accumulation of human capital are among the most important for enhancing long-run living standards (see, *e.g.* Cohen and Soto, 2007; Bouis *et al.*, 2011). However, the productivity benefits from education reforms typically take time to materialise while potential labour utilisation benefits may be felt sooner, *e.g.* for Vocational Education and Training (VET) that effectively enhance employment prospects among youth and the low skilled. Education has been an area of fairly active reform over the past few years, but changes have often been incremental, reflecting perhaps the high cost and uncertainty of comprehensive reforms. And, the costs of some education reforms can be a major concern at a time of fiscal consolidation. However, cost efficiencies can be achieved within many countries' education systems while maintaining, or even raising, output levels as discussed in the 2011 edition of *Going for Growth* (OECD, 2011a). Policy priorities include both reforms aimed at improving the performance of the education system and those that seek to reduce inequality of educational opportunities, as the latter may also contribute to lower labour productivity and utilisation (Causa and Johansson, 2009).

Policy priorities in education are identified for a vast majority of OECD countries, as well as all of the BRIICS countries except Russia. However, the recommendations vary across countries according to the more specific nature of the weaknesses. They can be grouped into several areas as summarised in Table 1.5.[31] There is a strong focus on primary and secondary education for the BRIICS but also for a number of OECD countries who still need improvement at compulsory levels of education, with a common emphasis on recommendations aiming at raising teacher quality and a higher prevalence of priorities to ensure adequate school resources and infrastructure in lower-income countries. Addressing educational inequalities is also a frequent priority in both BRIICS and OECD countries, with a focus on enhancing the targeting and effectiveness of resources devoted

Table 1.4. **Product market reform recommendations in OECD and BRIICS countries**

	Australia	Austria	Belgium	Canada	Chile	Czech Republic	Denmark	Estonia	European Union	Finland	France	Germany	Greece	Hungary	Iceland	Ireland	Israel	Italy	Japan	Korea	Luxembourg
Reduce economy-wide regulatory burdens																					
Reduce cost and legal barriers to entry													✔	✔			✔	✔	✔	✔	
Ease business exit														✔							
Improve the transparency of regulation															✔						
Streamline permit and licensing systems												✔			✔		✔				
Strengthen the competition framework					✔		✔									✔	✔				
Reduce the scope of public ownership/state intervention															✔			✔	✔		
Reduce sector-specific regulatory burdens																					
Energy and other network sectors		✔	✔	✔					✔		✔		✔	✔	✔	✔	✔		✔	✔	
Retail trade and professional services		✔		✔			✔		✔	✔	✔	✔	✔	✔		✔			✔	✔	✔
Reduce barriers to FDI and international trade	✔			✔											✔				✔	✔	

	Mexico	Netherlands	New Zealand	Norway	Poland	Portugal	Slovak Republic	Slovenia	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States	Brazil	China	India	Indonesia	Russian Federation	South Africa
Reduce economy-wide regulatory burdens	✔																			
Reduce cost and legal barriers to entry				✔	✔	✔	✔													✔
Ease business exit																				
Improve the transparency of regulation			✔														✔			✔
Streamline permit and licensing systems				✔		✔												✔		
Strengthen the competition framework								✔												✔
Reduce the scope of public ownership/state intervention	✔				✔			✔								✔			✔	
Reduce sector-specific regulatory burdens																				
Energy and other network sectors	✔		✔	✔	✔	✔	✔	✔	✔			✔			✔	✔	✔			✔
Retail trade and professional services				✔	✔	✔	✔		✔											
Reduce barriers to FDI and international trade	✔		✔														✔	✔	✔	

Table 1.5. **Human capital reform recommendations in OECD and BRIICS countries**

	Australia	Austria	Belgium	Canada	Chile	Czech Republic	Denmark	Estonia	France	Germany	Greece	Hungary	Iceland	Ireland	Israel	Italy	Japan	Korea	Luxembourg
Primary and secondary education																			
Ensure adequate school resources and infrastructure																			
Improve teaching quality					✔				✔		✔	✔	✔						
Improve school accountability and autonomy						✔					✔		✔			✔			
Improve curricula and evaluation					✔		✔				✔		✔		✔				
Postpone early tracking						✔				✔		✔							
Limit grade repetition									✔										
Improve incentives to secondary education completion							✔					✔							
Reduce inequality in educational opportunities					✔	✔			✔										
Tertiary education																			
Increase university autonomy									✔										
Introduce an evaluation system for universities											✔								
Introduce/raise tuition fees with income-contingent repayment loan		✔				✔		✔	✔	✔					✔	✔			
Improve incentives to earlier completion/encourage early admission							✔												
Expand access/enrolment/reduce inequalities in access		✔		✔	✔			✔		✔									
Expand/enhance the effectiveness of vocational education and training								✔	✔			✔				✔			

	Mexico	Netherlands	New Zealand	Norway	Poland	Portugal	Slovak Republic	Slovenia	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States	Brazil	China	India	Indonesia	Russian Federation
Primary and secondary education																			
Ensure adequate school resources and infrastructure	✔											✔					✔		
Improve teaching quality	✔		✔	✔										✔			✔	✔	
Improve school accountability and autonomy			✔	✔								✔					✔		
Improve curricula and evaluation						✔								✔	✔				
Postpone early tracking							✔												
Limit grade repetition									✔										
Improve incentives to secondary education completion													✔						
Reduce inequality in educational opportunities			✔			✔	✔					✔	✔	✔		✔		✔	
Tertiary education																			
Increase university autonomy					✔												✔		
Introduce an evaluation system for universities																			
Introduce/raise tuition fees with income-contingent payback					✔		✔	✔	✔		✔								
Improve incentives to earlier completion/encourage early admission										✔									
Expand access/enrolment/reduce inequalities in access																✔			
Expand/enhance the effectiveness of vocational education and training			✔			✔	✔		✔	✔	✔	✔	✔		✔				

to disadvantaged students and schools. Recommendations in the area of tertiary education are more prevalent for OECD countries, with a majority of priorities aimed at increasing autonomy and enhancing funding, *e.g.* by introducing or raising tuition charges and, in order to alleviate their adverse effects on enrolment, combining these with income-contingent payback.[32]

The pay-off from policy reforms in the area of VET can be particularly important at the current juncture. A number of countries are being advised to expand or enhance the effectiveness of VET so as to address the skill mismatch and to provide a better bridge between education and the labour market. Not only can well-designed VET systems improve the overall quality and equity of secondary and tertiary education systems, but they can be particularly useful at raising employability among youth and the low skilled, an attractive property at a time when several countries face substantial levels of youth unemployment and a need to encourage requalification and redeployment. An example of good practice can be found in Germany, where the dual system is especially well developed, integrating work-based and school-based learning to prepare apprentices for a successful transition to full-time employment. One major strength is the high degree of commitment and ownership on the part of employers and other social partners (see *OECD Policy Reviews* of VET, OECD, 2010b and OECD, 2012e). Germany has maintained strong financial support for VET and apprenticeship even during fiscal consolidation, and youth unemployment has remained very low by international standards (see Quintini and Manfredi, 2009).

General taxation

Tax reforms have gained a prominent role on countries' policy agenda (see above). This reflects in part the pressing need to restore fiscal sustainability in many OECD countries, which calls for designing growth-friendly fiscal consolidation strategies – or for implementing revenue-neutral tax reforms where there is fiscal space. There is mounting evidence of the impact of the tax structure on economic growth, through effects not only on labour utilisation (discussed above) but also private investment and productivity (see, *e.g.* Arnold *et al.*, 2011; Bouis *et al.*, 2012). Hence policy recommendations to improve the tax structure often include reductions in labour (see above), or corporate (Australia, Canada, Japan and the United States) income taxation. Policies to combat tax evasion as well as to broaden the tax base are advocated in several countries (Australia, Austria, Canada, Denmark, Germany, Greece, Finland, France, Italy, Japan, the Netherlands, Switzerland, Turkey and the United States) as a way to reduce distortions while enhancing revenues. Reforms in this area would also have beneficial equity effects, as discussed in Chapter 2.

A more growth-friendly tax system can be achieved by shifting the tax burden away from direct income toward consumption, immovable property and the environment, as recommended to most countries featuring a priority in the tax area[33] (Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Italy, Japan, Korea, Netherlands, Poland, Sweden, Switzerland and the United States).[34] The scope for such reforms may be limited in some cases, as they may increase inequality, implying the need to cautiously address associated policy trade-offs (see Chapter 2). Some countries are also recommended to reduce distortions or fragmentation in their taxation systems (*e.g.* Norway and the United States) by aligning the taxation of different asset classes and in particular by reducing the implicit tax subsidy for owner-occupied housing, or by introducing an integrated nationwide value-added tax (VAT) system for domestic goods while reducing the labour tax wedge (Brazil).

Public sector reform

Reforms to improve the efficiency of government expenditure are expected to boost productivity performance in the long term. But they are also particularly attractive at a time of fiscal consolidation, which probably explains why they have been gaining momentum over the recent period (see above). Recommendations include rationalisation of local government (Hungary), improved monitoring mechanisms of public sector performance (Hungary, United Kingdom), for instance by introducing performance assessment (Greece and Iceland) and benchmarking (Finland), the development of e-services (Czech Republic) and increased transparency and competition in public procurement (Belgium, Czech Republic, Denmark and the European Union).

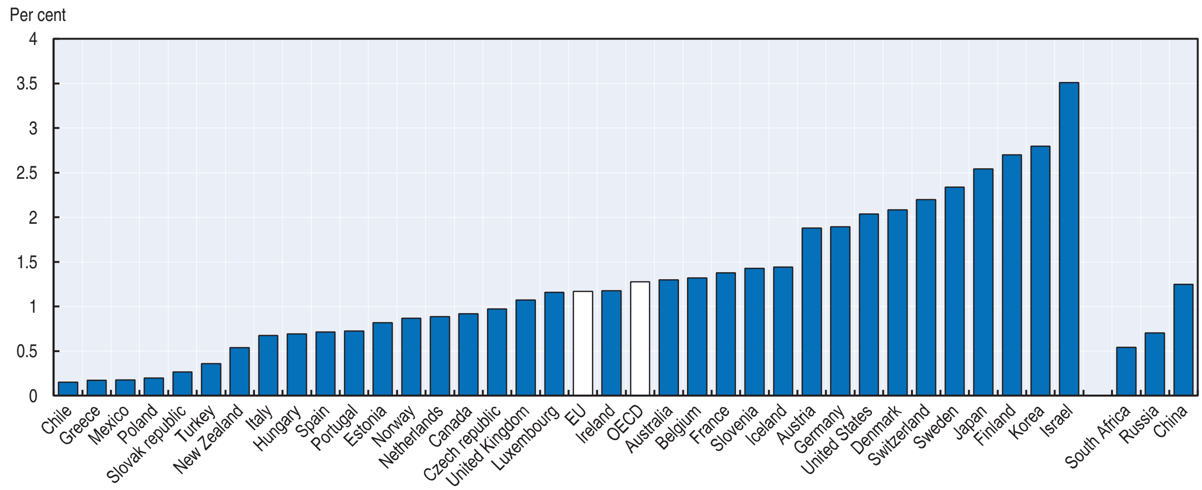
A number of public sector recommendations focus on the healthcare sector, given the considerable scope to increase cost-efficiency in a number of countries (OECD, 2011a). Reforms in this area cover the reinforcement of competition among healthcare providers (United Kingdom), the promotion of incentives to reduce administration and procurement costs (New Zealand) and moving from mixed to insurer-based hospital funding (Switzerland). The United States is being recommended to ensure that that the provisions of the Affordable Care Act aimed at increasing health insurance coverage and achieving cost savings are effectively implemented and their impact monitored. Major healthcare sector reforms are needed in Russia to improve its very weak outcomes, especially among the poor; beyond focusing on prevention efforts to change lifestyles, policy recommendations include increased funding and associated higher wages for medical professionals, but also the introduction of cost-sharing mechanisms and a shift from hospital to primary care.

Innovation

Innovation-related reforms boost productivity both by advancing the technology frontier (mainly in advanced OECD economies) and by speeding up the adoption of existing technology (in less advanced OECD and non-member countries). Alongside appropriate framework policies, *e.g.* in the area of education, infrastructure and product market regulations,[35] reforms of specific innovation policies – including public support measures – could help raise business expenditure on R&D in countries where it is relatively low (Figure 1.14). Specific recommendations are made to increase R&D tax incentives (New Zealand and Russia) or to reform their design *e.g.* by assessing them on changes instead of levels of activity (Ireland); to improve targeting of government support with a view to encourage firm growth through economies of scale (Canada), to foster export performance and energy savings (Estonia); to regularly assess the effectiveness of publicly funded projects (Czech Republic and New Zealand) and to take a balanced approach to supporting high- and low-technology sectors (Russia); to make greater use of competitive funding for research (Czech Republic and Russia) and improve access to venture capital (Slovak Republic). Successful innovation requires a strong human capital base, not least in science and engineering. Hence, priorities in this area often include strengthening collaboration between research institutes/universities and industry (Australia, Czech Republic, Ireland, New Zealand, Russia and the Slovak Republic).

Figure 1.14. **Business expenditure on R&D is uneven across countries**

Business enterprise expenditure on R&D as a percentage of GDP[1]



1. 2010 or last available year. 2007 for Greece and Mexico; 2008 for Chile, Iceland, South Africa and Switzerland; 2009 for Australia, New Zealand and the United States; 2011 for Canada, Germany and Italy.

Source: OECD, *Main Science and Technology Indicators Database*.

StatLink http://dx.doi.org/10.1787/888932775668

Agriculture and energy subsidies

Very little progress has occurred towards reducing agricultural subsidies, which explains why priorities in this area are renewed for Japan, Iceland, Korea, Norway, Switzerland, Turkey and the United States, who all need to further reduce the level of producer support and to de-link it from production (especially Japan and Korea) to mitigate its adverse effects on the efficiency of resource allocation. Similar recommendations are made for the European Union, in association with a reduction in barriers to market access for non-EU countries and of biofuel subsidies. Similarly to agricultural support, energy subsidies are sometimes used as social policy devices, but they distort markets and waste resources that could be more effectively targeted directly at the poor – such as through cash transfers – or at growth-promoting spending.[36] Reducing such subsidies substantially is a priority for Indonesia.

Other policies

- *Public infrastructure*: Enhancing the capacity of infrastructure – primarily transport systems – is a priority in some member countries, and this requires sparing infrastructure investment from expenditure cuts in the United Kingdom, expanding user and congestion charges in Australia and New Zealand and enhancing transport and communication infrastructure in Poland. Infrastructure provision levels are still low in many non-member countries, and an increase in investment is recommended in Brazil, India and Indonesia. While raising public investment is important, a reform of the regulatory environment for infrastructure would help to attract private investment and optimise use, *e.g.* by streamlining land acquisition processes (India), ensuring regulatory bodies' independence and accountability (Indonesia) and promoting more private-sector participation in infrastructure through more public-private partnerships and concessions (Brazil).

- *Financial services*: As discussed in the introduction, financial market reform has generally not featured prominently among country-specific priorities, owing to the particular need for strong international co-ordination in this area. There are nonetheless specific idiosyncratic cases where financial reform priorities feature in *Going for Growth*. The European Union has achieved considerable progress in the area of financial services, not least with the increasing integration of supervision as proposed by the Council of EU finance ministers. Still, further reforms to make the system more stable and integrated are needed, *e.g.* ensuring robust regulatory requirements, and continuing progress towards adopting a consistent set of rules, common supervisory practices covering all banks, and an EU-wide deposit insurance scheme while establishing bank resolution mechanisms based on common financing. Reflecting the lessons learnt from the housing crisis, a new priority in this area is identified for Ireland, where improved insolvency laws are recommended to help clean up bad loans faster and strengthen the banking system's capacity to provide credit to support future growth. More generally, basic financial-sector liberalisation is needed to sustain high growth in most non-member economies, including Brazil, China and India, where bank credit is not fully allocated by the market. However, in order to deliver their full benefits, such liberalisations should be gradual and accompanied by strong prudential regulation.
- *Reforms of governance systems and legal infrastructure*: Reform priorities in these areas are being made for some OECD countries, *e.g.* for Mexico to strengthen the "rule of law" by improving the accountability and professionalism of the judicial sector and for Israel to enhance corporate governance in large and complex groups, for instance by strengthening the rights of minority shareholders. Such types of recommendations are common to many non-member countries, including China where a strengthening of contract enforcement and some improvement in the effectiveness of courts is advocated to improve the predictability of the business environment. Institutional reforms that would help to fight corruption are recommended for Indonesia and Russia with the latter country being advised to simplify administrative regulations, reduce in the extent of bureaucratic discretion and reinforce judicial independence.

Notes

1. Structural reform commitments under the G20 Framework for Strong, Sustainable and Balanced Growth cover – with some cross-country variations – many of the same policies as the 2011 reform priorities (OECD, 2012b).
2. Specifically, the correlation coefficient between the 2011-12 responsiveness rate and trough-to-peak variation in yields on 10 year government bonds (computed based on quarterly averages constructed from daily data over the period 1Q2011-2Q2012), is equal to 0.6 and significant at the 1% level. Bond yield data are available for 21 countries only.
3. See Box 1.1 for methodological details on these indicators and country notes for details on actions taken in these countries.
4. The average responsiveness rate over 2011-12 is 0.25 for these countries as opposed to 0.48 for the whole euro area and 0.59 for the European countries under financial markets pressure (Greece, Estonia, Iceland, Ireland, Italy, Portugal, Slovenia and Spain).
5. These findings are broadly in line with recent analysis by the European Commission (EC). See Chapter 1, Part II in EC (2012).
6. See Chapter 4 of OECD (2012a) based on Bouis *et al.* (2012).

7. This is especially true for labour utilisation-enhancing priorities since the majority of recommendations identified for BRIICS countries are aimed at reducing their large labour productivity gap (see Table 1.1).
8. Despite being budget-neutral in the short term, product market reforms can improve debt sustainability over the long term *via* their positive impact on productivity and potential output.
9. All BRIICS countries except Russia have a policy priority in the area of human capital.
10. Labour productivity differences can be further decomposed into contributions from physical capital per worker, human capital per worker and total factor productivity (TFP), the residual measure of efficiency. There is large consensus in the literature that the bulk of labour productivity differences is explained by TFP and also that differences in income and TFP across countries are large and highly correlated. See Hsieh and Klenow (2010) and Jones and Romer (2010).
11. The relatively high level of measured productivity in these countries is, to some extent, a direct consequence of the relatively low share of lower-skilled workers in the labour force. In this regard, improvements in labour utilisation may not lead to one-for-one gains in overall income levels (see *e.g.* Boulhol, 2009).
12. South Africa is an exception though, combining relatively high informality with relatively low employment.
13. This assessment is based on indirect evidence such as the share of self-employment in total employment taken an as a proxy for informality because timely International Labour Organisation (ILO) informality statistics are not available for OECD countries apart from Mexico and Turkey.
14. Informality is often concentred in low-skill jobs and also prevents an efficient allocation of workers across firms and industries. For recent evidence on the detrimental effect of informality on productivity growth, see de Vries *et al.* (2012).
15. Roughly comparable reform priorities emerge from a concomitant survey carried over the same period by the Business and Industry Advisory Committee to the OECD (BIAC) in its Member and Observer organisations – *i.e.* the major national business and employer organisations in OECD countries and certain emerging economies. The survey included the assessment of businesses' perceptions of structural policy priorities in their country. There is a large degree of correspondence between BIAC's reported priorities and the *Going for Growth* 2013 priorities. However, there is a higher prevalence of labour utilisation-enhancing priorities in *Going for Growth* than in business and employers' organisations perceived priorities, with the latter being largely oriented towards boosting productivity through *e.g.* product market reforms.
16. For example, in the case of Italy, the recommendation to *reduce public ownership* (a separate priority in last edition) is now introduced as a part of a more general priority covering a somewhat broader set of recommendations to *reduce regulatory barriers to competition*. This has provided the scope for a new priority on *enhancing active labour market policies*.
17. However recent estimates for the euro area suggest that most countries experienced an increase in the structural unemployment rate, possibly reflecting labour market mismatch (ECB, 2012).
18. Introducing state-contingent policies such as automatic linkages between pensions and life expectancy may also improve policy predictability.
19. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.
20. As with any form of public wage subsidy, STW schemes also entail some risks *e.g.* of deadweight losses and displacement effects (see OECD, 2012a).
21. See Venn (2012) for an in-depth review of eligibility criteria across OECD countries.
22. See *e.g.* Barthélémy *et al.* (2006); Lepage-Saucier *et al.* (2012); Lemoine and Wasmer (2010); Cahuc and Kramarz (2005); Boeri and Garibaldi (2008).
23. However one of the potential shortfalls of the Austrian model is that the savings account is transferred to an investment fund and consequently severance pay partly depends on the capital market performance of the fund. Recent empirical evidence suggests that this can distort the labour market behaviour of workers (see *e.g.* Hofer *et al.*, 2011).
24. This can also be a problem in countries with informality problems, although minimum wages can also help attract workers to the formal sector.

25. Depending on country-specific circumstances, reforms in the housing area are considered to improve either of these two dimensions of overall economic performance. Because on balance most of the housing recommendations refer to the labour utilisation channel, they are presented in the current section.

26. OECD estimates (OECD, 2009) suggested that two-thirds of the OECD-wide decrease in potential output came from a permanently higher cost of capital with the remainder coming from lower potential employment. See also a recent McKinsey Global Institute report, where it is argued that behind Europe's growth stagnation is an unprecedented weakness in private investment which should be unlocked by removing regulatory barriers *e.g.* in energy and network industries (McKinsey Global Institute, 2012).

27. See recent reports *e.g.* on G20 trade and investment measures (OECD, WTO OMC and UNCTAD, 2012) and Global Trade Alert (GTA) on protectionism (GTA, 2012).

28. See *e.g.* Barone and Cingano (2011); Bourlès *et al.* (2010); Conway *et al.* (2006); Bas and Causa (2012).

29. While it may be argued that the negative effect of any particular regulatory burden is smaller than in more advanced economies, because the adverse impact on innovation incentives is less critical farther from the technological frontier (Aghion and Howitt, 2009; Bourles *et al.*, 2010), the magnitude and scope of existing regulatory burdens are particularly large in these countries, implying that they can be highly damaging for productivity. Bas and Causa (2012) provide recent evidence of the substantive gains from product market reforms in China.

30. See Bassanini and Duval (2009) for evidence on complementarities between labour and product market reforms.

31. Early education recommendations are discussed in the section on policy barriers to female participation though reforms in this area may also bring growth benefits *via* other channels *e.g.* productivity, for instance by boosting the benefits of later education (Causa and Johansson, 2009; OECD, 2011e).

32. The differential focus between primary and secondary versus tertiary education priorities is consistent with empirical findings showing that the pay-off from the latter is higher in advanced countries producing new (frontier) technology while the former is more productivity enhancing for catching-up countries, which generally import existing (frontier) technology (Aghion and Howitt, 2009; Vandenbussche *et al.*, 2006)

33. Depending on countries' situation, it is not necessarily being recommended to increase the three taxes at the same time, see country notes (Chapter 3).

34. The ongoing debate on how to minimize the negative short-run effects of fiscal consolidation has also focused on "growth-friendly" tax reforms aimed at raising revenue in the least distortionary way. Recent empirical analysis by de Mooij and Keen (2012) point to a potential positive effects (in particular for euro area countries) of so-called "fiscal devaluation" – *i.e.* e reduction in employers" social security contributions financed by increased VAT – on net exports. However, this favourable trade effect is found to disappear in the long run as wages adjust to lower social security contributions.

35. The OECD's Innovation Strategy has highlighted the importance of a broad range of education, regulatory, infrastructure and other policies that can help strengthen innovation systems, potentially durably enhancing productivity growth (OECD, 2010c). See also *Going for Growth 2006*, containing a special policy focus on innovation (OECD, 2006).

36. Energy subsidies may also lead to higher green house gas (GHG) emissions by encouraging overconsumption of fossil fuels.

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ANNEX 1.A1

How policy priorities are chosen for Going for Growth

The *Going for Growth* structural surveillance exercise seeks to identify five policy priorities for each OECD member country, the BRIICS (Brazil, China, India, Indonesia, Russia and South Africa) and the European Union. Three of these policy priorities are identified based on internationally comparable OECD indicators of policy settings and performance. The additional two priorities are often supported by indicator-based evidence, but draw principally on country-specific expertise. They are meant to capture any potential policy imperatives in fields not covered by indicators.

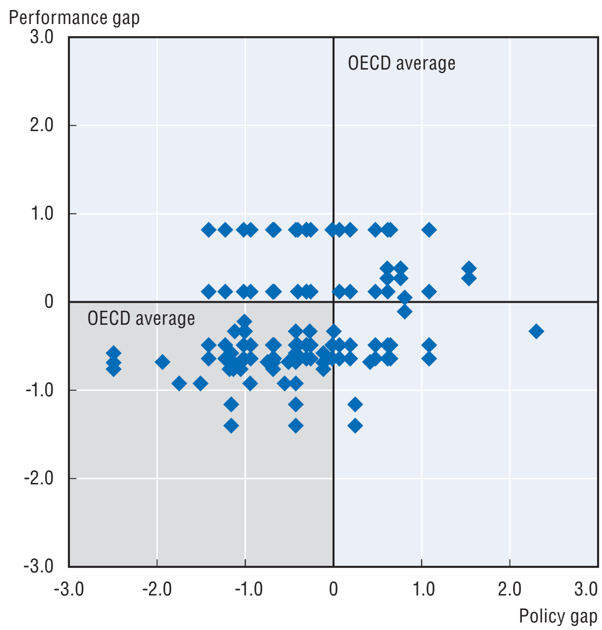
For the selection of the three indicator-based policy priorities, the starting point is a detailed examination of labour utilisation and productivity performance along with some of their underlying components (*e.g.* for the former, labour market outcomes of specific groups such as youth, women and older workers and, for the latter, multifactor productivity growth or investment in information and communications technology) so as to uncover specific areas of relative strength and weakness for individual countries. Each performance indicator is juxtaposed with corresponding policy indicators, where empirical research has shown a robust link to performance, to determine where performance and policy weaknesses appear to be linked.

For instance, based on empirical evidence provided in *e.g.* Bourlès *et al.* (2010) and Arnold *et al.* (2008), multifactor productivity growth (performance indicator) is matched with specific areas of product market regulation such as administrative burdens on start-ups or barriers to entry in retail or professional services (policy indicators). In the case of labour utilisation, aggregate employment (performance indicator) is paired for example with the level of the labour tax wedge (policy indicator) while female employment (performance indicator) is matched with childcare related costs embedded in tax and benefits systems (policy indicator). Empirical support for such relationships is reported in *e.g.* Bassanini and Duval (2006) and Jaumotte (2004).

This evaluation process is carried out for each of the approximately 50 areas where OECD policy indicators provide coverage. Since many of the policy indicators are associated with more than one performance area, there are more than 100 potential pairings examined, against a benchmark of the OECD average in given policy and performance areas.

As an example, Figure 1.A1.1 below shows, for a sample country, a scatter plot of pairings of policy indicators (on the horizontal axis) with corresponding performance indicators (on the vertical axis). The indicators are standardised by re-scaling them so that each has a mean of zero and a cross-country standard deviation of one, with positive numbers representing positions more growth-friendly than the OECD average. The scatter plot is thus divided into four quadrants, depending on whether a country's policy-performance pairing is below or above the average policy or performance score.

Figure 1.A1.1. **Selection of candidates for *Going for Growth* priorities**



Candidates for recommendations thus fall into the lower left quadrant (shaded area), where policy indicators and corresponding performance are *both* below the OECD average. In most countries there are more than three unique policy areas that qualify as potential priorities (for instance, Australia had 14 candidate priorities in 2013). Given the overall limit of five in the number of priorities per country, a selection is required. The policy priorities list is narrowed based on: *i)* country expertise; *ii)* the normalised distance of the policy stance from the benchmark (the OECD average), and *iii)* recent trends in policy and performance. Hence the priority selection process is mainly done with a focus on maximizing long-run level of GDP per capita, but consideration is also given to the current macroeconomic situation – in particular budgetary constraints – which could for example imply that certain 'costly' policy priorities may need to be phased in or postponed against a more urgent need to restore healthy public finances.

The linking of specific policy and performance areas is well grounded from a theoretical and empirical perspective in a vast body of academic literature. Also, the main empirical relationships have been the object of OECD studies, some of which are listed below in the Bibliography. At the same time, strengthening and developing the empirical analysis and underpinnings is an ongoing process. Some new empirical evidence on the policy drivers of labour market performance is provided for instance in de Serres *et al.* (2012) and Bouis *et al.* (2012). Moreover, subject on data availability, research efforts are also being undertaken in providing empirical evidence including or focusing on the BRIICS (*e.g.* Bouis *et al.*, 2011; Bas and Causa, 2012).

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