Economic Policy Reforms
Going for Growth - 2007 Edition

Summary in English

A large number of OECD countries have failed to narrow the gap in GDP per capita vis-à-vis the leading countries over the past decade, calling for a re-assessment of the main policies having an impact on the key growth drivers. *Going for Growth* was launched two years ago to help improve well-being in OECD countries through a systematic comparison of national public policies and their outcomes. Although it should not degenerate into slavish imitation, drawing lessons from others' successes and failures is a powerful avenue for progress. While allowance should be made for genuine differences in social preferences across OECD countries, the uniqueness of national circumstances should not be used as a convenient way to paper over the persistence of inefficient policies.

The first issue of *Going for Growth* inaugurated a new form of benchmarking surveillance, based on structural policy indicators with a well-identified link to economic performance. Using these indicators, along with measures of performance in a broad range of economic areas and detailed expertise of OECD committees and staff, a set of five policy priorities was derived for each OECD member. The second issue of *Going for Growth*, released in 2006, followed up on progress made in the policy areas identified as priorities and broadened the scope of indicators underpinning the structural surveillance exercise to take into account policies to stimulate innovation.

As in the first issue, *Going for Growth 2007* identifies, for all individual countries and the European Union, five policy priorities most likely to boost the growth of GDP *per capita* in the future. At least three of these policy priorities are based on internationally-comparable indicators of performance and policy settings. The additional two priorities are not necessarily supported by indicators but draw on country-specific expertise in order to capture important policy areas that cannot always be assessed on the basis of quantitative indicators.

Chapter 1 provides an overview of broad trends in growth performance in OECD countries over the recent past and the policy priorities that have been identified to address specific performance weaknesses. The specific recommendations made in the context of those priority areas are discussed in greater detail in the country notes in *Chapter 2* and the set of policy indicators used to select the priorities are presented in *Chapter 3*. The country notes also document earlier measures, if any, taken to address the problem identified and provide new recommendations.

Given that high unemployment and low labour force participation remain a major preoccupation in many continental European countries, measures to improve the labour market performance account for the majority of policy priorities in these economies. For low-income countries, as well as in Japan and Switzerland, raising productivity is the main challenge and hence priorities tend to focus more on liberalisation of product markets, especially in network industries and services. English-speaking countries have generally good labour market performance, but have in common the need to raise the level of skills, in particular via an improvement of secondary education. Finally, a large number of EU countries share the need to strengthen their higher-education systems in order to improve graduation rates and /or the quality of teaching and research performed.

Chapter 4 builds on recent OECD research undertaken within the context of the reassessment of the *Jobs Strategy,* as well as on the wide body of available research on labour markets, to identify some of the policies and institutions that shape employment outcomes. Following a brief review of changes in labour market performance over the past decade, it assesses the main policy influences on employment *via* labour supply and demand in the aggregate and for specific groups; explores the role of macroeconomic policies and their interplay with existing policy frameworks, and examines the benefits of hypothetical reforms in OECD countries.

It finds that, on average, changes in policies and institutions explain about half of the cross-country variance in unemployment trends over the past two decades. In general, high and long-lasting unemployment benefits, high tax wedges and stringent anti-competition product market regulation (PMR) increase unemployment and depress labour force participation. By contrast, highly centralised and/or coordinated wage bargaining systems as well as certain categories of public spending on active labour market programmes (ALMPs) appear to reduce unemployment. Different policy packages may yield similar employment outcomes, although not necessarily with the same effect on overall economic performance and public finances.

Apart from these general policies, the job prospects of certain population groups such as older workers, women and youth are also influenced by other, more specific, policies. For example, early retirement incentives embodied in public pension schemes and other social transfer programmes depress employment at older ages. Childcare subsidies boost female participation but child benefits reduce it. As well, a minimum wage set at a too high level is likely to deteriorate the job prospects of youth.

Chapter 5 explores how competition-restraining product market regulation has affected the international diffusion of best-practice production techniques. It looks at how such regulation evolved up to 2003; how it affected productivity catch-up in the face of the rapid developments in ICT of the past decade; and how reforms aimed at strengthening competition could raise growth and contribute to productivity convergence among OECD countries. Despite a broad tendency towards product market liberalisation, regulations still restrict competition in non-manufacturing sectors. Competition-restraining product market regulations have an adverse effect on productivity as they slow the adoption of best-practice production techniques. And this particularly harms countries that are far behind the technological frontier in some industries.

Restrictive regulation retards the diffusion of new technology through at least two channels: it discourages investment in equipment that embodies the latest ICT, and reduces the diffusion of technology from abroad through foreign direct investment (FDI). For instance, over the period 1995-2003, estimates suggest that the annual productivity growth could have been at least ¾ of a percentage point higher in half of the countries considered if regulations that hinder competition had been at the level of the most lightly regulated in the OECD for each sector.

Drawing on in-depth reviews in recent Economic Surveys of individual OECD countries, *Chapter 6* takes stock of policies that influence competition, with a focus on the remaining obstacles to competition rather than on the progress achieved to date. It finds that competition laws prohibit horizontal cartels in most countries, but in some cases sanctions are below deterrent levels, the scope for private suits is limited and there are insufficient legal mechanisms to induce cartel members to defect. In a few countries, competition law is not applied to government-related entities and companies, which distorts competition with private companies.

Furthermore, in several countries, regulations still limit competition in a number of sectors. In particular, this is the case in retail distribution and professional services, preventing potential efficiency gains *inter alia* related to economies of scale, trade in services and labour mobility. In network industries, the major remaining challenges are how to create a level playing field between firms of different ownership (*e.g.* domestic and foreign, public and private) in particular in access to networks and how to provide investment incentives for owners of newly-privatised public monopolies.

Governments throughout the OECD are committed to undertake structural reforms to strengthen growth, employment and public finances. That the pursuit of these objectives requires in many countries extensive structural reform is also broadly recognised. Yet, progress has been uneven across both countries and policy fields. One reason for this arises from possible trade-offs with worthwhile non-economic objectives. However, differences in the depth, scope and timing of reform also reflect political constraints. Better understanding the factors behind resistance to reform and finding the ways to overcome it are at the core of the so-called “political economy of structural reforms”.

These political economy issues are the subject of *chapter 7*, which provides a brief review of reform patterns in OECD countries before taking stock of recent OECD research on the way in which economic and political conditions can affect the course of reform in product and labour markets. The review of the evidence on factors affecting structural reform implementation points to some tentative lessons, positive and negative, that can be learned from the past experience with economic reform highlighted by OECD surveillance processes.

First, economic analysis suggests that while market-oriented reforms help boost global incomes, they may also induce losses for some people, at least in the absence of offsetting compensation. The fact that opposition to reform is often grounded on complexities related to the costs and benefits of policy changes and the trade-offs between economic and other objectives suggests that comprehensive and transparent explanations are essential elements of successful structural reforms.

Second, because they take time to materialise and are often diffuse, gains from reforms are perceived as uncertain. By contrast, those who stand to lose from change can easily identify themselves and unite to block reforms, thus leading to “the tyranny of the status quo”. The difficulties confronting collective action in the reform area lead to a situation where crisis is the main driver for institutional change. What would be needed, rather, is timely reform to avoid situations where finally the cost of inaction becomes so manifestly prohibitive that it dwarfs the short-run costs of reform.

On a brighter note, the empirical research presented in the chapter suggests that smaller countries may be more alert and adept at introducing timely reforms. The same would seem to hold where political systems are conducive to government stability or where the fiscal position is strong enough to allow adequate compensation for losers. Some reforms may also be easier to carry out than others: liberalising financial markets, international trade and, to some extent, product markets seems to be politically less sensitive than labour market reforms.

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