Economic Policy Reforms

Going for Growth

2011

OECD

Economic Policy Reforms 2011

GOING FOR GROWTH

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Going for Growth *was launched in 2005 as a new form of structural surveillance complementing the OECD's long-standing country and sector-specific surveys. In line with the OECD's 1960 founding Convention, the aim is to help promote vigorous sustainable economic growth and improve the well-being of OECD citizens.*

This surveillance is based on a systematic and in-depth analysis of structural policies and their outcomes across OECD members, relying on a set of internationally comparable and regularly updated policy indicators with a well-established link to performance. Using these indicators, alongside the expertise of OECD committees and staff, policy priorities and recommendations are derived for each member and, starting from the 2011 edition, six key non-member economies with which the OECD works closely (Brazil, China, India, Indonesia, Russia and South Africa). From one issue to the next, Going for Growth *follows up on these recommendations and priorities evolve, not least as a result of governments taking action on the identified policy priorities.*

Underpinning this type of benchmarking is the observation that drawing lessons from mutual success and failure is a powerful avenue for progress. While allowance should be made for genuine differences in social preferences across OECD members, the uniqueness of national circumstances should not serve to justify inefficient policies.

In gauging performance, the focus is on GDP per capita, productivity and employment. As highlighted in the past and again in this issue, this leaves out some important dimensions of well-being. For this reason, Going for Growth regularly features thematic chapters dedicated to these other dimensions, and increasingly looks at the side effects of growth-enhancing priorities on other government policy objectives.

Going for Growth *is the fruit of a joint effort across a large number of OECD Departments.*

www.oecd.org/economics/goingforgrowth

Editorial

The Many Dividends from Structural Reform

The global recovery has been underway for some time now, but it remains uneven. Emerging market economies are growing strongly, while growth in OECD economies has been insufficient to significantly reduce unemployment from its post-crisis peak with all of the attendant human and social costs. Global payment imbalances are widening again. How sustainable post recession global growth will be? Policy driven recovery has still not been fully replaced by self sustained, job rich growth, especially in advanced economies. At the same time policy space is reaching its limits, in both the fiscal and monetary policy domains. Monetary policies have been stretched to their limits, and public budgets are in need of consolidation – and indeed most OECD governments are tightening fiscal policy in 2011 and beyond. In addition, the recovery takes place against the background of permanent scars from the recession that, while difficult to assess precisely, are associated with output losses in most advanced economies that are likely to persist for several years.

In such a scenario structural policy reforms provide the main available policy lever to speed up the recovery and raise global growth over the coming years, while at the same time offering significant contribution to global rebalancing and fiscal consolidation, as discussed in Chapter 1 of this year's edition. Financial markets are also doing a better job at pricing longer-term economic prospects – and therefore the effects of reforms (or lack thereof) – in bond yields now than in the past, further strengthening the case for action. Although more needs to be done to address key issues such as systemic risk or non-bank financial institutions, financial regulation reform is on its way, with capital, liquidity and leverage ratios for banks due to be raised or introduced across the OECD. Efforts need to be stepped up in other areas, where structural reforms have been rather modest since the start of the crisis.

Structural policy reforms have gained prominence in the G20 context since the Mutual Assessment Process was set up at the 2009 G20 summit in Pittsburgh. The OECD has relied on Going for Growth *to contribute to assessing the policy commitments made by G20 countries and identifying further reforms to improve global outcomes. Indeed this new edition of* Going for Growth *identifies five key priorities to boost long-term growth for each individual OECD country – including Chile, Estonia, Israel and Slovenia, which joined the organisation in 2010 – and, for the first time, for key emerging countries with which the OECD works closely, namely Brazil, Russia, China, India, Indonesia and South Africa – the so-called BRIICS. These recommendations provide readily-available benchmarks against which domestic reform plans can be, and indeed have been assessed.*

For OECD countries, a number of these Going for Growth *recommendations could deliver much-needed short-term growth benefits, such as reductions in entry barriers in sectors with strong immediate job-creation potential like retail trade or liberal professions. Many priorities would also alleviate risks that low current employment levels become permanent, such as reforms of social* *transfer programmes and activation policies. Some policies that have not traditionally featured high on the* Going for Growth *agenda, such as work-sharing arrangements, cushioned unemployment and helped workers stay in contact with the labour market during the recession. New OECD analysis will have to draw the full policy lessons from these experiences. Other labour market policy responses to the crisis, such as extensions in the coverage of unemployment benefits, helped to mitigate hardship on workers and could usefully stay in place. Some policy responses, such as extended duration of benefits, have also provided necessary protection during the recession and its aftermath but will in many cases have to be rolled back at a pace consistent with improving labour demand. More generally,* Going for Growth *features a wealth of recommendations upon which OECD governments can draw to strengthen the job content of the ongoing recovery. For the BRIICS,* Going for Growth *priorities aim primarily at speeding up or maintaining ongoing convergence to OECD living standards, and include inter alia strengthening education systems, relaxing stringent product market regulations and addressing the more specific challenges of labour market informality and – in some cases – the quality of governance and legal systems.*

Many of the structural reform recommendations we make in this edition of Going for Growth *could deliver double and even triple dividends in the current economic situation. They would stimulate growth, which is their stated goal. They could also assist ongoing fiscal consolidation. This is especially true of labour market reforms that would boost employment levels, as well as of cost-saving public sector reforms. For instance, in a special chapter, we report new OECD analysis which points to potential public spending savings from improving the efficiency of health care systems of almost 2% of GDP on average across OECD countries. Furthermore, some of the structural reform recommendations to individual OECD and non-OECD countries could contribute to reducing global current account imbalances. Another special chapter on this issue suggests that a package of fiscal consolidation and structural reforms may reduce global imbalances by about a third.*

While reforms can help address the policy challenges of the post-crisis world, they are also needed to ensure that past mistakes are not repeated and the risk of future crises is dramatically reduced. This requires enhancing not only financial market regulation but also the functioning of housing markets, where misguided policy interventions have magnified the crisis. In that regard, the main findings from our special chapter are clear: there is much room for housing market reform in many OECD countries, and better housing policies could deliver more efficient and equitable housing outcomes, increase geographical mobility and improve macroeconomic stability going forward. It is not too late to fix them.

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Chief Economist, OECD

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ISO Codes

The codes for country names and currencies used in this volume are those attributed to them by the International Organization for Standardization (ISO).

Country code	Country name	Currency code
AUS	Australia	AUD
AUT	Austria	EUR
BEL	Belgium	EUR
BRA	Brazil	BRL
CAN	Canada	CAD
CHE	Switzerland	CHF
CHL	Chile	CLP
CHN	China	CNY
CZE	Czech Republic	CZK
DEU	Germany	EUR
DNK	Denmark	DKK
ESP	Spain	EUR
EST	Estonia	EUR
FIN	Finland	EUR
FRA	France	EUR
GBR	United Kingdom	GBP
GRC	Greece	EUR
HUN	Hungary	HUF
IDN	Indonesia	IDR
IND	India	INR
IRL	Ireland	EUR
ISL	Iceland	ISK
ISR	Israel	ILS
ITA	Italy	EUR
JPN	Japan	JPY
KOR	Republic of Korea	KRW
LUX	Luxembourg	EUR
MEX	Mexico	MXN
NLD	Netherlands	EUR
NOR	Norway	NOK
NZL	New Zealand	NZD
POL	Poland	PLN
PRT	Portugal	EUR
RUS	Russia	RUB
SVK	Slovak Republic	SKK
SVN	Slovenia	EUR
SWE	Sweden	SEK
TUR	Turkey	TRL
USA	United States	UDS
ZAF	South Africa	ZAR

Executive Summary

The global recovery from the deepest recession since the Great Depression has been underway for some time now, but it remains overly dependent on macroeconomic policy stimulus and has so far been insufficient to address high and persistent unemployment in many countries. With fiscal stimulus bound to be gradually withdrawn to address unsustainable public debt dynamics and little if any further support to be expected from monetary policy, the main challenge facing OECD governments today is turning a policy-driven recovery into self-sustained growth. Speeding up the structural reform process, which outside the financial regulation area has slowed during the global recession, could make a decisive contribution in this regard. In a context of crisis recovery, priority may be given to reforms that are most conducive to short-term growth and help the unemployed and those outside the labour force to remain in contact with the labour market.

This new edition of Going for Growth identifies for each OECD country and, for the first time, for key emerging economies (Brazil, China, India, Indonesia, Russia and South Africa, the so-called BRIICS), five reform priorities that would be most effective in delivering sustained growth over the next decade. These recommendations are determined based on a mapping between the performance shortfalls – measured by labour productivity and labour utilisation gaps vis-à-vis best performers – and policy weaknesses of each individual country. The main conclusions from this priority-setting exercise, which are summed up in an overview chapter (Chapter 1) and described in greater detail in individual country notes (Chapter 2) are as follows:

- Higher income OECD countries face a range of policy challenges and can roughly be broken down into two groups. The first group consists primarily of continental European countries, which need to raise labour utilisation. In consequence, improving the design of benefit systems, addressing labour market dualism through job protection reform and shifting the tax burden away from labour are common recommendations, although product market reforms also feature prominently. The remaining relatively wealthy OECD countries face a more balanced set of challenges, with a greater focus on labour productivity – especially for the Asian member countries – and with reforms of network sector regulation, FDI restrictions, tax structure and public sectors frequently recommended.
- Lower income OECD countries – including Chile, Estonia, Israel and Slovenia that joined the OECD in 2010 – and the BRIICS face far more challenges related to their education systems and product market regulation. Reforms in these areas are aimed at enhancing productivity. Labour informality also raises specific policy challenges in these countries. In many cases, the nature of policy priorities for the BRIICS is similar in content to that for low-income OECD countries, though the amount of needed reform is typically greater in the BRIICS. Recommendations for the BRIICS and some lower-income OECD countries

also include in several cases reforms of legal systems and contract enforcement as well as improvements in governance systems that would address corruption.

- Reforms that would deliver quick income and job gains come at a premium in post-crisis circumstances. Among the identified policy priorities, such reforms include lower barriers to competition (*e.g.* in retail trade or liberal professions), fewer administrative burdens on business and removal of barriers to foreign direct investment. Some of the identified priorities could also go a long way towards preventing high unemployment from becoming permanent, another important concern in the current environment. Many of the labour market policy responses to the crisis – such as the scaling-up of short-time work schemes or extensions in the length and coverage of unemployment benefits – helped dampen the unemployment impact of the recession and mitigated hardship on workers. As the economic conditions evolve, new policy initiatives could help strengthen the job content of the recovery. Such reforms include increased spending on and reform of active labour market policies, reduced labour market dualism through job protection reform and improved design of social transfer programmes.
- The current economic situation has ambiguous implications for the ability of governments to undertake reforms, with the post-crisis context making their necessity more apparent but the weaker fiscal positions in many countries possibly being an obstacle. Against this background, it is essential to ensure that reforms are consistent with the pressing need for fiscal consolidation.
- Structural reforms are mainly aimed at enhancing long-term income levels but could also yield important co-benefits for fiscal balances. For example, reforms that boost employment levels are likely to be helpful to fiscal consolidation. Unsustainable public finances have also made many other types of structural reforms more urgent. In particular, improvements in tax systems, or education and health care efficiency gains could ease fiscal deficits.

Growth-enhancing structural reforms can also have beneficial knock-on effects on current account imbalances, as examined in detail in Chapter 5. Despite some narrowing during the crisis, global imbalances are still wide in both OECD and non-OECD countries and are likely to remain so in the absence of policy action. While structural reforms are not generally designed to address global imbalances, they can affect current accounts by influencing households' and firms' saving and investment decisions, as well as by altering public saving and investment. New empirical analysis presented in this chapter suggests that a number of structural reforms that are desirable *per se* could also reduce global imbalances by narrowing the gaps between domestic saving and investment in several major economic areas:

- Developing social welfare systems in China and other Asian economies would fulfil an important social goal, and as a side-effect would reduce the need for precautionary saving, thus curbing the large current account surpluses of some of these countries.
- Pension reforms that increase the age of retirement would boost income levels while also helping to reduce saving and current account surpluses (but raise deficits in external deficit countries).
- Product market reforms in network industries, retail trade or professional services could encourage capital spending and thereby reduce current account surpluses in countries such as Japan and Germany.
- Removal of policy distortions that encourage consumption, such as tax deductibility of interest payments on mortgages in the absence of taxation of imputed rent, could help

increase household saving and reduce external deficits in a number of countries, not least the United States, though implementation would have to await greater stabilisation of the economy.

- Financial market reforms that increase the sophistication and depth of financial markets could relax borrowing constraints in emerging economies and thereby boost consumption and investment, thus helping to reduce the current account surpluses observed in some of them. Such reforms need to be accompanied by appropriate prudential controls.
- Overall, a combination of fiscal tightening in OECD countries, product market reforms in Germany and Japan, and increased public health spending (by 2 percentage points of GDP) and financial market liberalisation in China could reduce the size of global imbalances by about one-third.

This issue of *Going for Growth* contains a special chapter on housing (Chapter 4), an area where misguided policies contributed to trigger the recent crisis and could now slow down labour mobility and the job recovery. The chapter presents new housing market policy indicators and OECD empirical analysis, with the following main findings:

- Innovations in mortgage markets should be coupled with appropriate regulatory oversight and prudent banking regulations. Financial liberalisation and mortgage innovations have boosted the access to housing of previously credit-constrained households, but regulatory reforms in mortgage markets may also be behind noticeable increases in house prices – by an average of 30% in OECD countries between the early 1980s and the mid-2000s – and in house price volatility.
- Housing supply could be made more responsive to demand in many OECD countries, for example by streamlining cumbersome construction licensing procedures. This would help to avoid excessive volatility in house prices. At the same time, greater responsiveness may also translate into more volatile residential investment unless volatility of demand can be curbed.
- Housing policies can facilitate residential mobility, allowing a better match of workers with jobs and thereby helping the labour market recover from the recent crisis. Reducing the high costs involved with buying a residence would improve access to credit and housing supply responsiveness. It could also enhance residential mobility, as would some easing of relatively strict rent controls and tenant-landlord regulations.
- Housing policies should be designed to be efficient and equitable. Tax distortions should be removed by taxing housing and alternative investments in the same way. Provided they are carefully designed, targeted social housing systems can achieve their goals at least cost, and well-designed portable housing allowances may be preferable to the direct provision of social housing as they do not seem to directly hinder residential mobility.

Last but not least, this year's issue of *Going for Growth* features a chapter on health care (Chapter 6), a key contributor to individual well-being and an important driver of long-term economic growth. The OECD has assembled new cross-country comparative data on health policies and health care system efficiency, which show that there is room in all countries surveyed to improve the effectiveness of their public health care spending:

- On average across the OECD, life expectancy at birth could be raised by more than two years, while holding health care spending steady, if every country were to become as efficient as the best performers.

- For more than one-third of countries, better efficiency could improve life expectancy as much in the ten years to 2017 as in the previous ten years, while keeping health care spending constant.
- Alternatively, improving the efficiency of health care systems could result in large public spending savings approaching 2% of GDP on average in the OECD.
- There is no single type of health care system that performs systematically better in delivering cost-effective health care. It may thus be less the type of system that matters but rather how it is managed. Policymakers should aim for coherence in policy settings by adopting best practices from the different health care systems and tailor them to suit their own circumstances. Nevertheless, the international comparison highlights a number of sources of potential efficiency gains, such as from improving the coordination of the bodies involved in health care management, strengthening gate-keeping, increasing out-of-pocket payments, enhancing information on quality and prices, reforming provider payment schemes or adjusting regulations concerning hospital workforce and equipment.

PART I

Structural Policy Priorities

PART I

Chapter 1

An Overview of Going for Growth Priorities in 2011

This initial chapter of Going for Growth identifies five structural reform priorities for each OECD country, for the European Union as a whole, and for the BRIICS – Brazil, China, India, Indonesia, Russia and South Africa. The recommendations are aimed at addressing variations in labour productivity and labour use across these countries. Moderate and high income (mainly European) OECD countries need to improve their labour use mainly by reforming their benefit and job protection systems and labour taxes. The relatively wealthy Asian member countries face a more balanced set of challenges, with a greater focus on labour productivity. The reform challenges for lower income OECD countries and the BRIICS relate to their education systems and product market regulation, as well as labour informality.

The chapter also reports the number of reform priorities that would directly and quickly improve the fiscal balance, and also estimates for most OECD countries the potential cost savings that could be reaped by implementing best practice in their national education and health care systems. It turns out that implementing many of the Going for Growth priorities could not only enhance living standards but also contribute to more balanced fiscal positions, as well as to lower global current account imbalances.

Summary and conclusions

Going for Growth reports have been published by the OECD every year since 2005. The *Going for Growth* analysis identifies five structural reform priorities for each OECD country and for the European Union (EU) as a whole.[1] This seventh edition of *Going for Growth* has been expanded to cover the four new member countries that joined the OECD during 2010, namely Chile, Estonia, Israel[2] and Slovenia, as well the BRIICS – Brazil, China, India, Indonesia, Russia and South Africa – key non-member countries with which the OECD works closely.[3] The *Going for Growth* process provides a tool for governments to reflect on "structural" policy reforms that affect their residents' long-term living standards. Structural policy reforms are central to the mission of the OECD, and the *Going for Growth* analysis has been used in the Mutual Assessment Process of the G20 since the Pittsburgh Summit. Since policy recommendations are only reconsidered or set every other year (in odd years), this is the fourth time that a full set of recommendations has been made for OECD member countries since the first edition of *Going for Growth* (OECD, 2005) and the first time it has been made systematically for the BRIICS. The methodology used identifies policy recommendations based on their ability to improve long-term material living standards. The reference performance measure in this regard is gross domestic product (GDP) per capita, given its contemporaneous availability and relatively broad coverage despite its potential drawbacks.[4] Some measures that extend GDP numbers to non-market production, and thereby may come closer to indicators of well-being, are explored in Annex 1.A3.[5] Recognising that policy reforms often pursue multiple objectives rather than just income growth, this chapter also looks at the side-effects of structural policy recommendations on two other "burning" policy objectives, namely achieving fiscal sustainability and reducing current account imbalances (see also Chapter 5).

The crisis is writ large in this year's *Going for Growth*, vividly demonstrating the urgency of reforms in the financial sector for restoring stability and protecting living standards over the long-term (see Box 1.1).[6] In a context of crisis recovery, priority may be given to reforms that are most conducive to short-term growth and job gains, such as reducing entry barrier regulation (*e.g.* in retail trade or liberal professions), administrative burdens on business and international barriers that restrict foreign direct investment (FDI). The dramatic effects of the crisis on economies globally has made many previously-identified structural policy priorities even more urgent – particularly those that would allow countries' slack labour resources to remain in contact with the labour market. These include increasing spending on and reforming active labour market policies, reducing labour market dualism through job protection reforms or making social transfer programmes more conducive to employment. All these labour and product market reforms could help to reduce the extent of hysteresis, the process whereby jobless workers end up being unable to seek and find employment.

Main findings from the chapter include:

- Moderate and high income OECD countries face a range of policy challenges and can roughly be broken down into two groups. The first group consists primarily of continental European countries, which need to raise labour utilisation, and where reforms of benefit systems, job protection and labour taxes are common recommendations, although product market reforms also feature prominently. The remaining relatively wealthy OECD countries face a more balanced set of challenges, with a greater focus on labour productivity – especially for the Asian member countries – and with reforms of network sector regulation, FDI restrictions, tax structure and public sectors frequently recommended.
- Lower income OECD countries – including the new members – and the BRIICS face far more challenges related to their education systems and product market regulation, reforms of which are aimed at enhancing productivity levels. Labour informality also raises policy issues in these countries. In many cases, the nature of policy priorities for the BRIICS is similar in content to that for low-income OECD countries, though the amount of needed reform is typically greater in the BRIICS. Recommendations for the BRIICS and some lower income OECD countries also include in several cases reforms of legal systems and contract enforcement as well as improvements in governance systems that would address corruption.
- The current economic situation has ambiguous implications for the ability of governments to undertake reforms, with the post-crisis context making their necessity more apparent but the deteriorated fiscal positions in many countries possibly being an obstacle. Against this background, it is essential to ensure that reforms are consistent with the pressing need for fiscal consolidation. The current context of slack resource use would also favour implementing first those reforms that are known to bring stronger short-term gains, such as the removal of various barriers to competition.
- Structural reforms are mainly aimed at enhancing long-term income levels but could also yield important co-benefits for fiscal balances. For example, reforms that boost sustainable employment levels are likely to be most helpful to fiscal consolidation. The urgency of many other types of structural reforms has also increased. In particular, improvements in tax systems, or education and health care efficiency gains could ease fiscal deficits (see Chapter 6 on health).
- Structural reforms can also have important and beneficial knock-on effects on current account imbalances. Such imbalances may be affected more by some types of structural reforms than others. In this chapter, conclusions are drawn regarding different types of growth and welfare-enhancing structural reforms that would also help reduce saving-investment imbalances, depending on whether a country is in fiscal surplus or deficit, and whether it has an external surplus or deficit. For instance, in economies characterised by current account surpluses and fiscal deficits, easing product market regulations in sheltered sectors would not only boost growth but could also contribute to reduce current account surpluses by increasing investment, and to some extent help consolidate public finances; and in dual surplus countries with weak social protection, a strengthening of social benefits would enhance welfare by reducing the risk of hardship and could lower both saving surpluses (see Chapter 5 on current account imbalances).

Box 1.1. **Financial market reform**

The recent financial crisis and its subsequent severe impact on growth and employment have been a forceful reminder of the vital role of prudential regulation in financial markets for helping to preserve overall economic stability. Well-functioning financial sectors not only reduce the cost of producing and trading goods and services but also reduce the risks of instability. And given that financial crises generate long-lasting output losses (Furceri and Mourougane, 2009; Cerra and Saxena, 2008), enhanced stability could also contribute to higher long-term living standards. At the same time, when evaluating the current proposals and actions to strengthen prudential regulation frameworks, attention needs to be paid to preserving the well-established benefits from financial market competition. Competition matters for efficient financial intermediation, and for the pricing and quality of financial products. It can also facilitate access of firms and households to external financing and financial services, with potentially far-reaching consequences for economic growth and living standards. Fortunately, however, previous OECD analysis finds only limited trade-offs between stability and competition, and even suggests that stronger supervisors could go along with more competitive banking systems (OECD, 2010a, Chapter 6). Similarly, regulatory reform would have to strike the right balance between stability on the one hand and the cost of capital on the other. Indeed, strengthening prudential regulation might raise the long-term cost of capital with permanent adverse effects on capital accumulation and income levels. For instance, a 1 percentage point increase in core capital requirements may lead to a rise in the lending spread – the spread between bank lending and borrowing rates – by about 16 basis points, *ceteris paribus* (MAG, 2010). If reform were to raise the cost of capital in proportion with the share of bank lending in the external financing of non-financial businesses, Cournede's (2010) estimates would suggest a negative impact on potential output in the order of 0.2% in the United States and 0.6% in the euro area (assuming an offsetting monetary policy response). However, the aforementioned calculations omit the gains from the new capital framework, which include the reduced likelihood and cost of financial crises and improvements in the quality of capital allocation across the economy. These effects have been estimated to more than offset any gross costs of the new regulations, by a wide margin (BCBS, 2010).

For the BRIICS, the challenges are somewhat different. Financial markets are typically much shallower than in most OECD countries, implying low levels of financial inclusion and a more limited role for financial intermediation in capital allocation. To some extent, this reflects more stringent regulation, in particular larger barriers to entry, and higher state ownership. International evidence suggests that high state-ownership of banks tends to depress financial sector development, with negative implications for long term living standards, especially for countries with less developed financial markets (see Levine *et. al.*, 2005).

Together with actions by individual countries and the EU, a comprehensive regulatory reform is being discussed under the auspices of the G20 in recognition of the need for internationally co-ordinated rules to strengthen financial stability, in particular by reducing opportunities for regulatory arbitrage. One vital component of such a regulatory regime has been agreed in general principles, in the form of the Basel III agreement. This agreement effectively triples the size of capital reserves that banks must hold against loses over the period 2011-18, by raising the Tier 1 capital ratio from 2% to 4.5% of risk-weighted assets, and adding a further 2.5% buffer. By strengthening global capital and liquidity regulations, banks should have larger buffers to cushion downturns. These new requirements will be phased in gradually, and US and EU banks already meet them, Box 1.1. **Financial market reform** *(cont.)*

although they may want to keep a discretionary buffer above the regulatory mimima. As a result, any adverse impacts on growth over the coming years are likely to be very small, though they could reach between 0.1 and 0.6 percentage points of GDP growth per annum for Japan depending on the extent of credit-supply effects (based on MAG, 2010).

While many other details of the new financial sector reforms are still to be determined, broad consensus has been achieved on a number of principles beyond the strengthening of capital requirements (also see OECD, 2010b; 2010c; OECD, 2010d):

- Design macro-prudential policy so as to mitigate procyclical build-up of systemic risk and help alleviating the accumulation of credit-driven asset price bubbles. Develop tools to reduce the pro-cyclicality of the financial system such as contingent capital buffers with capital surcharges being applied on top of prevailing micro- prudential capital ratios, dynamic loss provisioning, or risk weights that are a function of aggregate borrowers' leverage. Establish robust institutions for macro-prudential regulation, with adequate resources and access to information to develop early warning and systemic assessment tools.
- Reduce moral hazard posed by systemically-important institutions and the associated economic damage. Options for addressing the "too-big-to-fail" problem being discussed include: targeted (or progressive) capital, leverage, and liquidity requirements; improved supervisory approaches; simplification of firm structures; strengthened national and cross-border resolution frameworks, including the development of "living wills" for major cross-border firms (see below); and changes to financial infrastructure that reduce contagion risks.
- Impose a maximum leverage ratio applicable to all types of assets. Progress on a binding standard for the leverage ratio has been hindered by a lack of international convergence in accounting standards on ending the netting of derivative positions. This lack of convergence also means that new, tighter capital requirements may have different degrees of effectiveness among countries, and, in conjunction with the risk weighting approach, entails incentives for shifting risk outside the banking system.
- Introduce cross-border crisis management mechanisms. This can be achieved by ensuring that: *i)* national authorities have an effective toolkit for bank resolution, harmonised as far as possible; *ii)* all systematically cross-border institutions have functioning stability groups, supported by regularly updated living wills; *iii)* burden-sharing agreements enshrined in national laws exist to limit ring fencing between countries.
- Reform non-bank financial institutions. There is the risk that tightening of bank regulation will encourage the shifting of risk to other parts of the financial sector. It is particularly important to ensure that insurance and pension fund regulations prevent build-up of systemic risk.
- Implement sound compensation practices at large financial institutions to ensure that they structure their compensation schemes in a way that does not encourage excessive risk taking.
- Strengthen accounting standards. The International and US Financial Accounting Standards Boards (IASB and FASB) have been considering approaches to improve and simplify accounting for financial instruments, provisioning and impairment recognition, and are converging, albeit slowly.

Box 1.1. **Financial market reform** *(cont.)*

In the OECD, individual countries and jurisdictions have taken initiatives to reform financial regulation to tackle the failures that led to the financial and economic crisis. Measures to strengthen framework conditions in financial markets have nevertheless proceeded at different speeds across countries, advancing faster in the United States. In particular:

- In the United States, the financial reform legislation enacted in July 2010 establishes a consumer financial protection entity, creates a systemic risk regulator (the Financial Stability Oversight Council), gives regulatory bodies the authority to determine which derivatives should be cleared through centralised clearing houses, creates a banking liquidation authority and a pre-funded liquidation fund, and bans banks from using their regulatory capital to finance some categories of risky investments (the "Volcker Rule"), in particular requesting banks to spin off part of their proprietary trading desks.
- In the European Union (EU), the authorities have decided to establish a macro prudential oversight body (the European Systemic Risk Board), and three European supervisory authorities (covering banking, insurance and pensions, and securities respectively) to set common technical standards and ensure efficient and harmonised (cross-border) supervision. Authorities have also advanced in harmonising and simplifying deposit guarantee schemes (increasing the overall level of protection), the heterogeneity of which was disruptive for financial stability during the crisis. They also intend to put in place a banking crisis management mechanism to deal effectively with the failure of European banks (including through the establishment of colleges of supervisors for large cross-border groups). As well, the European Commission has launched a consultation document to harmonise rules and tools relating to short selling across member states.
- At the national level, some EU countries have taken measures on their own. Some countries have imposed (France, Germany and Sweden) a levy on banks to reduce taxpayer costs of future bank failures and financial crises. Germany imposed a ban on naked short-selling of certain types of securities. In the United Kingdom, the authorities undertook in the second half of 2010 a three-month consultation period on a reform that intends to place both firm-specific and macro-prudential regulation (through new powers) under the auspices of the Bank of England. The new regulatory system is not expected to be in place before 2012 to allow the financial sector to adjust. Moreover, an independent commission has been given one year to report on the issue of separating retail and investment banking and the need to break-up large banks. A levy on banks will be implemented starting from January 2011 to encourage banks to move away from risky funding. Outside the EU, Switzerland imposed tighter liquidity and solvency requirements on the country's two biggest banks, including a leverage ratio and a capital buffer that varies over the profit cycle.

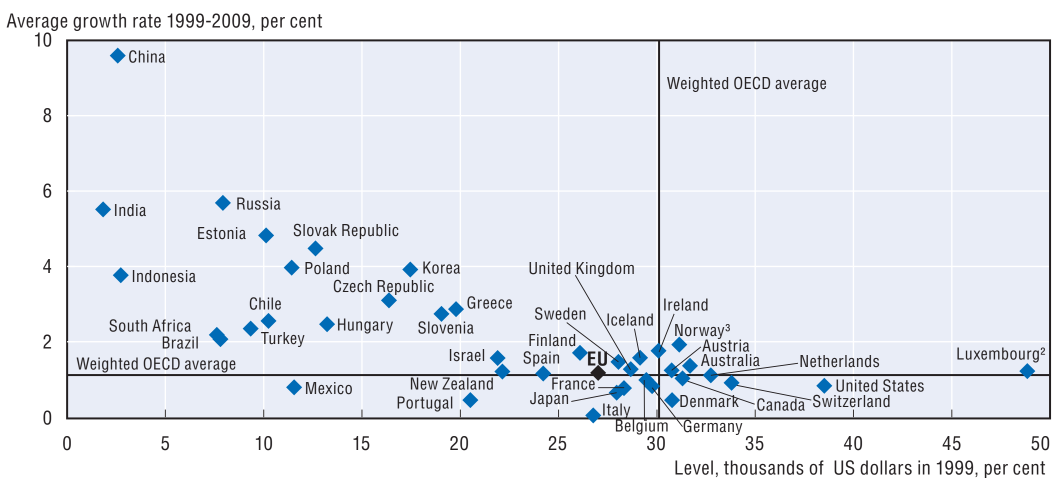
Areas where international coordination still needs to advance further include the regulation of the over-the-counter derivatives market and accounting standards. Regarding the former, it is important that authorities across both sides of the Atlantic agree on a common set of derivatives that should be traded through central clearing houses in order to avoid shopping for the most favourable set of rules. On the latter, it is important not to lose momentum in converging on global high quality financial reporting standards in spite of the postponement from June to end-2011 of the deadline for convergence fixed by the G20. Finally, international coordination of prudential supervision is particularly important for countries in a monetary union. Upgrading regulation and supervision to reduce risk in the euro area calls for an effective system of cross-border supervision and an integrated crisis management framework to reduce moral hazard.

This chapter first gives an overview of economic performance and looks at variations in labour productivity and labour resources use across the OECD countries and the BRIICS, in order to understand the relative areas of performance weakness by country. It then discusses the general orientation and focus of the policy recommendations that result from mapping performance weaknesses to policy deficiencies for each individual country. In the final parts of the chapter, the implications of growth-enhancing structural reforms for fiscal challenges and current account imbalances are addressed.

Growth performance in OECD and BRIICS countries

Examining both OECD and BRIICS countries' growth rates over the past decade compared with their income level a decade earlier (Figure 1.1) reveals that there has been some convergence in income levels. There were a number of exceptions, however, as higher relative levels were maintained by Luxembourg, Norway and to a lesser extent the United States, and some OECD countries including Italy, Mexico and Portugal had below-average growth rates in spite of starting at lower income levels. Among the BRIICS, the most rapid convergence is observed for China, India and Russia, while it has been weakest for Brazil and South Africa.

Figure 1.1. **GDP per capita levels and growth rates**[1]



1. GDP per capita, in constant 2005 purchasing power parities (PPPs).
2. 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.
3. 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.

Source: OECD (2010), *National Accounts Database* and OECD (2010), *OECD Economic Outlook No. 88: Statistics and Projections Database*.

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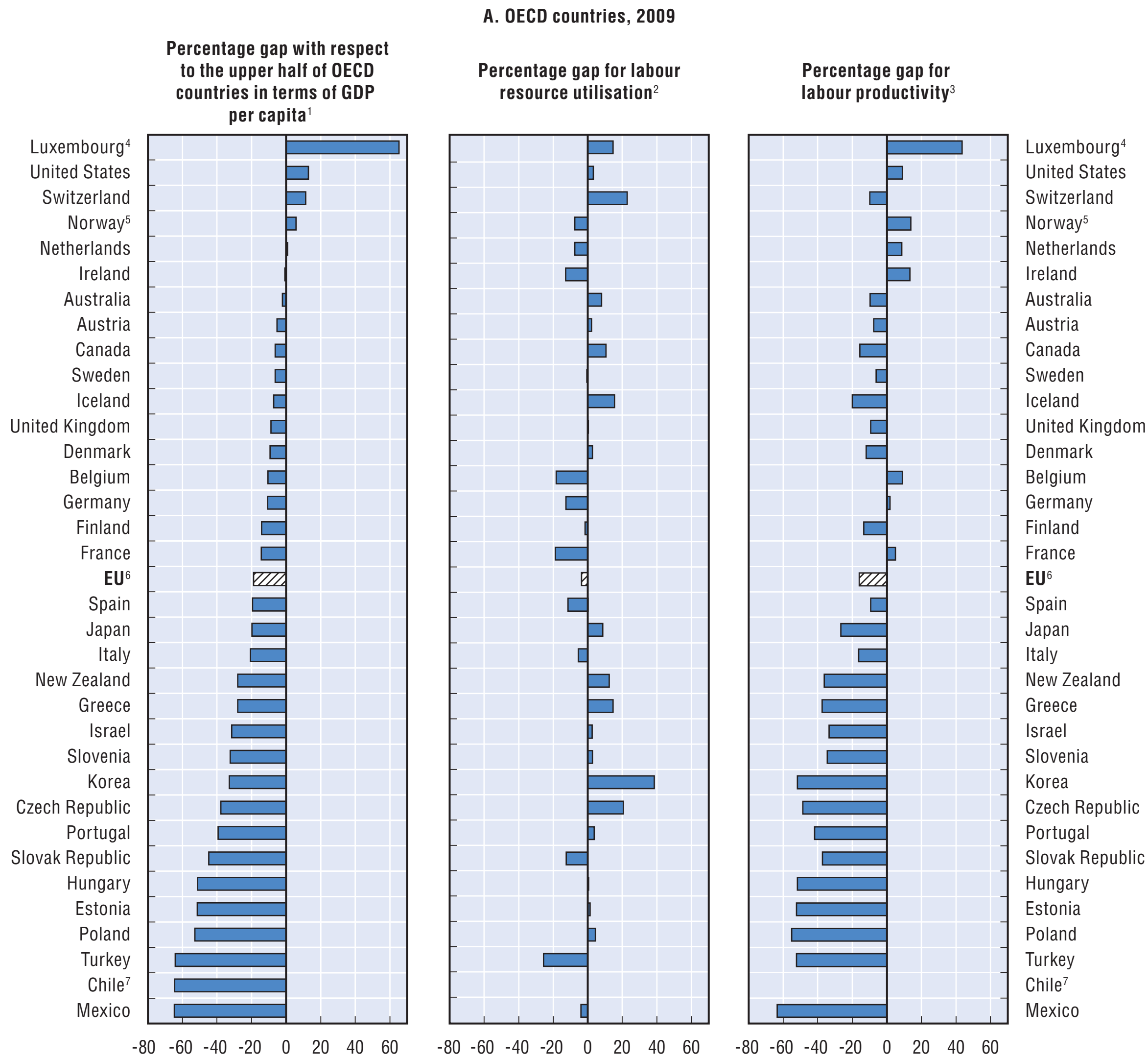
Decomposition of GDP per capita gaps

Gaps in GDP per capita relative to the simple average of the upper half of OECD members can be decomposed into contributions from, respectively, hourly labour productivity and labour utilisation (Figure 1.2, Panel A). The decomposition reveals several different groups of countries:

- *High income/high productivity*: the highest income countries (Luxembourg, Norway and the United States in particular) typically have high productivity, although Switzerland stands out as an exception.

Figure 1.2. **The sources of real income differences**



1. Relative to the simple average of the highest 17 OECD countries in terms of GDP per capita, based on 2009 purchasing power parities (PPPs). 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 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. EU brings together countries that are members of both the European Union and the OECD. These are the EU15 countries plus Czech Republic, Estonia, Hungary, Poland, the Slovak Republic and Slovenia.
7. Data on hours worked are not available for Chile.

Source: OECD (2010), *National Accounts Database*; OECD (2010), *OECD Economic Outlook No. 88: Statistics and Projections Database* and OECD (2010), *OECD Employment Outlook: Moving beyond the Jobs Crisis*.

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- *Average income/high labour utilisation*: Australia, Canada, Greece, Iceland,[7] Japan and Korea all have moderate to high incomes with comparatively high labour utilisation, offset by a negative gap in their labour productivity.

- *Average income/high productivity*: Belgium, France, Germany, Ireland, the Netherlands and Spain all suffer from a negative gap in their labour utilisation, offset by comparatively high labour productivity.
- *Average income/average labour utilisation and productivity*: Austria, Denmark, Finland, Sweden and the United Kingdom have similar gaps in both labour productivity and labour utilisation that explain their income levels.
- *Lower income/low productivity*: the dozen countries with the lowest GDP per capita levels face primarily productivity deficiencies, though the Slovak Republic and Turkey also face labour utilisation shortfalls.

A separate decomposition is made for the BRIICS, using headcount productivity data (Figure 1.2, Panel B). 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, including when compared to the average OECD country. Russia has the highest income in the BRIICS group, and its shortfall is virtually all a labour productivity gap. Among the remaining BIICS, labour productivity shortfalls dominate except for South Africa, where labour resource utilisation is a major challenge, and to a more limited extent, India. In contrast, China has a positive gap in labour utilisation.

Figure 1.2. **The sources of real income differences** *(cont.)*

B. BRIICS countries *vis-à-vis* the OECD (using headcount productivity data) 2008

1. Relative to the simple average of the highest 17 OECD countries in terms of GDP per capita, based on revised 2008 purchasing power parities (PPPs) from the World Bank. 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 per capita, based on KILM database estimates. In turn, employment per capita combines both the employment rate of the working-age population and the share of working-age individuals in the population. The latter reflects a demographic effect that may vary across countries and can be especially important for emerging countries in demographic transition (*e.g.* this factor reduces the overall employment rate in India, all else being equal).
3. Labour productivity is measured as GDP per employee.

Source: World Bank (2010), World Development Indicators (WDI) and ILO (International Labour Organisation) (2010), *Key Indicators of the Labour Market (KILM) Databases.*

StatLink http://dx.doi.org/10.1787/888932372830

Policy reforms in the OECD and the BRIICS

Five key policy recommendations are made to enhance convergence in living standards across the OECD and the BRIICS, using quantitative performance and policy indicators to select the first three priorities, in areas where performance and policy weaknesses coincide.[8] The remaining two priorities are made 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). 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.

Compared with the 2009 vintage of *Going for Growth*, a number of policy priorities for individual countries have been altered. Overall, the share of priorities that have changed is comparable with what happened in the 2009 exercise and the modifications have been more in terms of coverage than in thrust. Specifically, among the pre-enlargement OECD countries, 57 out of 155 policy priorities have been changed compared with the 2009 exercise, with 16 dropped or merged as a result of actions taken or a reconsideration of priorities. The most common shift in priorities was a broadening of their scope, which applied to 31 recommendations in 2011, compared with only ⅔ rds as many in 2009. Another 10 priorities were either refocused or narrowed, to more specifically target a revised policy challenge.

The focus of the response to the economic and financial crisis on short-term stabilisation and temporary measures has reduced the emphasis on basic long-term income-enhancing reforms. While the measures taken in response to the crisis have generally supported short-term demand and mitigated the longer-term income losses from the recession, it is crucial that policymakers now turn their attention to those policy reforms that will sustainably improve incomes in the longer term. Based on both economic and political economy arguments, it might be appropriate to adapt the timing of reforms so as to maximise short-term gains. Some of the reform priorities identified here would give a quick boost to growth and jobs. In particular, the productivity and employment effects associated with the removal of various anti-competitive barriers to competition can be large even in the short to medium run. Other reforms such as those associated with education or to a lesser extent social transfer programmes would take more time to deliver their full benefits.

In most cases, pushing through reforms will also require overcoming deeply-rooted political economy obstacles to reform. Recent OECD analysis of major past reform experiences has helped identify the main ingredients for success (Box 1.2). In particular, OECD case studies and empirical analysis highlight the facilitating effect of both crises and sound public finances. In that regard, the current economic situation has ambiguous implications for the ability of governments to undertake reforms, with the post-crisis context facilitating them and weakened fiscal positions in many countries possibly being an obstacle. Economic crises often make structural weaknesses more visible, and thus may provide incentives for pursuing difficult reforms, for example of labour and product market regulation (Tompson and Dang, 2010) as well as of the tax system (OECD, 2010e). Against this background, it is essential to ensure that reforms are consistent with the pressing need for fiscal consolidation. The political acceptability of structural reform may be enhanced if the authorities commit to well-specified *ex post* evaluation mechanisms.[9] Finally, to be accepted, structural reforms must be considered as equitable, or to be part of an overall balanced reform programme.

Overall, the balance of policy recommendations by subject area has remained quite stable for OECD countries in recent years, with the share of productivity-enhancing policy recommendations remaining at approximately 60% (Table 1.1). This ratio slightly increased in the most recent round, reflecting new priorities with respect to public sector efficiency, taxation structure, infrastructure and social mobility (grouped under “other” policy areas for the first three priorities and human capital for the last), partly following up on last

Box 1.2. **Making reform happen**

Going for Growth provides countries with recommendations about the structural reforms that they should consider implementing. However, the business of actually carrying out reform is complex, and involves a wide range of general political economy and more country-specific considerations. Recent OECD analysis has examined the political economy of reform in 20 country-specific case studies of reform episodes in 10 OECD countries as well as thematic treatments of the conditions that can make actual reform possible (see OECD, 2009a and 2010e). This work builds on earlier OECD work, including a chapter in the 2007 edition of *Going for Growth* that examined the issue using quantitative empirical analysis.

The review of OECD evidence suggests that a number of basic principles have often been successful (based on Tompson and Dang, 2010):

- *Governments need to have an electoral mandate for reform*. Reform "by stealth" has severe limits, and major reforms for which governments have not previously sought public approval tend to succeed only when they generate visible benefits very rapidly, which major structural reforms generally do not. While crises can create opportunities for reform surprises, sustainability is essential for real impact.
- *Effective communication by governments is important*. Major reforms have usually been accompanied by consistent coordinated efforts to persuade voters and stakeholders of the need for reform and, in particular, to communicate the costs of not reforming. Where, as is often the case, the costs of the status quo are opportunity costs, they tend to be politically "invisible", and the challenge is all the greater.
- *Policy design should be underpinned by solid research and analysis*. An evidence-based and analytically sound case for reform serves both to improve the quality of policy and to enhance prospects for reform adoption. Research presented by an authoritative, non-partisan institution that commands trust across the political spectrum appears to have a far greater impact.
- *Successful structural reforms take considerable time to implement*. The more successful reforms in the case studies generally took over two years to prepare and adopt – and this does not include the preparation work done in the many reform episodes in which problems and proposals had been debated and studied for years before the authorities set to work framing specific reforms.
- *Cohesion of the government is important*. If the government undertaking a reform initiative is not united around the policy, it will send out mixed messages, and opponents will exploit its divisions; defeat is usually the result. The case studies suggest that cohesion matters more than such factors as the strength or unity of opposition parties or the government's parliamentary strength.
- *Government leadership is essential*. Reform progress may sometimes be facilitated by intensive discussions involving the government and the social partners (*i.e.* unions and business groups) in a formalised process. However, firmness of purpose on the part of the government also seems to be a critical element of success in such situations. A co-operative approach is unlikely to succeed unless the government is in a position to reward co-operation by the social partners or can make a credible threat to proceed unilaterally if a concerted approach fails.
- *The condition of the policy regime to be reformed matters*. Successful reforms of established policy regimes often appear to have been preceded by the "erosion" of the status quo through smaller piece-meal reforms or reform attempts; where the existing arrangements are well institutionalised and popular and there appears to be no danger of imminent breakdown, reform is far more difficult.
- *Successful reform requires persistence*. A further important implication of the finding concerning reform ripeness is that blocked, reversed or very limited early reforms need not be seen as failures: they may play a role in illustrating the unsustainability of the status quo and setting the stage for a more successful attempt later on.

The OECD case studies also provide further evidence in support of some of the major findings identified by the OECD's earlier econometric work, particularly with respect to the facilitating effect of crises and sound public finances. Finally, the case studies cast some doubt on the often-repeated claim that voters tend to punish reforming governments: the likelihood of subsequent re-election was about the same for the more and less successful reform episodes.

Table 1.1. **Distribution of *Going for Growth* policy recommendations by subject area**

Per cent

Going for Growth edition	2005	2007	2009	2011	2011	
	Pre-enlargement OECD				OECD in 2011	BRIICS
Productivity						
Product market regulation	30	25	25	24	26	33
Agriculture	5	5	5	5	4	0
Human capital	10	14	15	15	15	17
Other policy areas	17	15	14	18	17	30
Total	63	59	58	61	61	80
Labour utilisation						
Average and marginal taxation on labour income	8	7	8	8	8	0
Social benefits	17	20	17	17	17	7
Labour market regulation and collective wage agreements	10	12	13	11	11	10
Other policy areas	2	2	3	3	2	3
Total	37	41	42	39	39	20
Overall	100	100	100	100	100	100
Overall (*number of priorities*)	155	155	155	155	175	30

year's *Going for Growth* edition which featured new empirical research in these domains. Some labour reform recommendations were refocused or removed, as a result of some progress in strengthening activation (see *social benefits* below). The balance of priorities between labour productivity and labour utilisation-enhancing reforms among the new member countries does not markedly change the overall composition.

For the BRIICS, four-fifths of the policy recommendations are aimed at improving productivity, reflecting these countries' relative weakness in this area. There is a strong focus on product market regulation, which is often much more stringent than in OECD countries, and education systems, where quality and achievement levels are relatively low. By contrast, compared to a number of OECD countries, where reducing support is a recommendation, there are no specific priorities on agriculture since support is relatively low. Several additional policy areas are also covered where reforms could boost productivity, including government/governance reform, intellectual property rights protection, and basic financial regulatory liberalisation. These domains are particularly important policy areas for these countries. There are fewer priorities aimed at enhancing labour utilisation, in part because most of the BRIICS have relatively high overall employment rates and less developed tax-benefit systems. Widespread informality is a greater challenge, as it can reduce economy-wide efficiency. A number of recommendations are intended to address this issue, such as relaxing overly strict job protection for permanent *vis-à-vis* other workers, containing labour costs or increasing the coverage of social protection systems.

Policy priorities to improve labour productivity performance

Product market regulation

A broad range of industry and country-level evidence illustrates the impact of product market regulation on the pace of convergence in productivity levels to technologically advanced economies (*e.g.* Bourlès *et. al.*, 2010; Conway *et. al.*, 2006). Moreover, the estimated impact of product market reform on GDP per capita is very high, with the long-term gains in living standards realised relatively rapidly (Barnes *et. al.,* 2011; Bouis and Duval, 2011). Reflecting the importance of this type of reform, recommendations in this area are made in all but five OECD countries (Finland, the Netherlands, Sweden, the United Kingdom and the United States). This is in spite of the fact that considerable reform has been undertaken in this field in recent years. Likewise, all of the new countries in the *Going for Growth* exercise had at least one product market regulatory reform recommendation, and for many of them there were even two such recommendations. Competition policy frameworks complement product market regulation, and authorities can help to ensure that markets are competitive. A strengthening of such frameworks and/or associated competition authorities is identified as a priority for Italy, Luxembourg and South Africa.

Within product market regulation, for half of the OECD member countries and all the BRIICS except Brazil, recommendations were made to reduce economy-wide regulatory burdens. These measures include a reduction of barriers to entrepreneurship (Austria, Chile, Czech Republic, France, Greece, Hungary, Israel, Italy, Mexico, New Zealand, Norway, Poland, Portugal) through a reduction in the cost and legal barriers to entry (Czech Republic, France, Germany, Greece, Iceland, Israel), the establishment of one-stop shops or simplification of entry procedures (Chile, Italy), and easing of business exit (Chile, Czech Republic, Hungary). A further streamlining of permit and licensing systems is also needed in Estonia, Germany, Iceland, Israel and Portugal.

In the BRIICS, a similar, but much larger reduction of administrative burdens on businesses and start-ups is recommended (China, India, Indonesia and South Africa). 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. Regulatory reforms could be aided by more systematic regulatory impact analysis (in China), to ensure that new and existing regulations are not overly costly. Complementary reforms that would reduce excessive state control and limit intervention in the operations of private firms are the subject of recommendations for several BRIICS countries. Though state ownership still appears to be excessive in some OECD countries, it is far more of an issue in China, Russia and South Africa where it appears to hurt efficiency.

Not only economy-wide but also sector-specific administrative burdens are still a problem in many industries:

- *Energy and other network sectors*: While in many OECD countries, reforms of network sectors have advanced considerably – within the EU often following European Commission directives – functional separation of supply and production in the energy sector is still identified as a priority. Beyond energy, further reform and cross-border integration of transport, postal, telecommunications and port services is a priority. Outside of the EU, restructured energy markets are also a priority in Canada, Iceland, Japan, Mexico, New Zealand, Switzerland and Turkey.
- *Retail trade and professional services*: For the EU as a whole, the full implementation of the 2009 Services Directive is a priority, with its provisions still not fully transposed into law in many member states. In retail trade, restrictions on opening hours in Belgium and Luxembourg and limits on the size or operation of larger outlets in France, Ireland, Portugal and Spain still remain an obstacle to competition, and are identified as

country-specific priorities. Professional services suffer from licensing requirements and compulsory chamber memberships that limit competition in a number of EU countries, where reforms are identified as priorities (Austria, Germany, Greece, Luxembourg, Portugal and the Slovak Republic). Beyond the EU, there has been progress in Canada to reduce inter-provincial barriers to labour mobility and competition in the skilled trades, but implementation is still lacking.

In a more limited number of OECD countries, reductions of barriers to foreign investment and ownership are identified as priorities. Restrictions in particular sectors are a concern in Canada (especially for telecom and air transport), Iceland (for fisheries and electricity), Japan (for services), Korea (for network sectors and services) and Mexico (services and infrastructure). Australia and New Zealand need to improve transparency of FDI screening procedures, while Estonia relies on a distortionary FDI grant system. Among non-member countries, a reduction of FDI restrictions (especially in services) is identified as a priority in India, Indonesia and Russia, with targeted trade barriers also being a problem in India and Russia – which introduced a particularly large number of discriminatory measures in wake of the financial crisis that have not yet been fully rescinded.

Human capital

Reforms that facilitate the accumulation of human capital are among the most important for enhancing long-run living standards, although it takes a generation for their benefits to be fully realised. One key dimension that is increasingly appreciated in the growth literature is that the quality of education is at least as important as the number of years of schooling (OECD, 2010f). Education recommendations are made for 25 OECD countries, as well as all of the BRIICS countries except Russia. These recommendations can be grouped into several areas:

- *Early and primary education*: enhancing access to, and the impact of early education programmes (Australia, Poland and the United Kingdom); improving schools' infrastructure (Greece, Mexico, South Africa); improving teacher training (Mexico, New Zealand, South Africa, the United States).
- *Secondary education*: strengthening school accountability and autonomy (Greece, Spain, Iceland, India, Mexico, Norway, Turkey, United States); improving curricula and evaluation (Brazil, Chile, Greece, Mexico, Portugal); postponing tracking (Austria, Czech Republic, Germany, Hungary, Italy, Switzerland); strengthening vocational education (Hungary, Portugal); and addressing inequalities in access (China, Indonesia, Israel, Slovak Republic).
- *Tertiary education*: increasing university autonomy (Austria, France); expanding vocational education (Brazil); introducing or raising tuition charges and, in order to alleviate their adverse effects on enrolment, combining these with income-contingent payback (Austria, Denmark, France, Czech Republic, Finland, Germany, Hungary, Israel, Italy, Slovak Republic, Slovenia, Sweden, Switzerland).
- *Social mobility*: last year's volume of *Going for Growth* examined the extent to which education policies (and tax and benefit systems) may affect social mobility, which can enhance entrepreneurship, the overall quality and allocation of human capital, work incentives and ultimately productivity. The United States is one of several OECD countries that do not do well on this account (Causa and Johansson, 2009), and reforms to improve equality of opportunity are identified as one of the top five priorities. These measures include strengthening early childhood education and enhancing the social mix in classrooms.

The costs of some education reforms are a concern at a time when the vast majority of OECD countries are contemplating fiscal consolidation. However, there can be considerable cost efficiencies to be had within many countries' education systems while maintaining, or even raising, output levels. This issue, and the potential scope for cost savings, is discussed at greater length in the fiscal section below.

Agriculture

Very little progress has occurred in reducing agricultural subsidies, especially with the closure of the Doha round of international trade negotiations being delayed so long. Producer support levels have fallen somewhat as a mechanical result of higher world market prices of agricultural commodities, but less so as a result of substantial reforms. Recommendations were renewed in this area for Japan, Iceland, Korea, Norway, Switzerland, the United States as well as the EU, 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. Biofuel subsidies entail high (implicit) carbon prices compared with other greenhouse gas mitigation instruments, and certain first-generation biofuels may in fact be carbon-intensive. Subsidies should therefore be reduced in the EU and the United States, while tariffs on imported ethanol should be removed.

Housing policies

Housing policies can affect both labour productivity and labour utilisation. Depending on country-specific circumstances, reforms in the housing area are considered to improve either of these two dimensions of overall economic performance.[10] Restrictive housing policies such as rent regulation can limit labour mobility, impede the smooth functioning of labour markets 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. A special chapter on this topic is included in this volume (Chapter 4). 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. Housing policies and rent regulation need to be revised in Denmark, Estonia, Luxembourg, the Netherlands, Poland, Slovak Republic, Sweden and the United Kingdom. In China, the only partial implementation of rural land management regulations deters permanent migration and thereby reinforces urban-rural distortions that hamper geographic mobility and ultimately overall productivity.

Other policy areas

A number of additional policy areas are identified as key priorities to boost labour productivity which apply more often to OECD countries but also in some cases to the BRIICS:

- *General taxation*: as highlighted in the 2009 edition of *Going for* Growth (OECD, 2009b), the structure of taxation can lead to distortions in the incentives to save, work and invest, reducing economy-wide productivity and labour input. Policy recommendations to improve the efficiency of the tax system are featured for Australia, Canada, Greece, Hungary, Italy, Japan, Korea, Portugal and the United States. These include the reduction of corporate taxes (Australia, Italy and Japan), as well as more general guidance to shift the structure of taxation toward consumption (and immovable property), which can raise GDP per capita. An introduction of an integrated nationwide value-added tax (VAT) system is recommended for Brazil and the United States – where the mortgage interest deduction and (limited) health insurance tax exclusion also still need to be reduced. Policies to reduce tax evasion as well as to broaden the tax base are advocated in several countries (Greece, Hungary, Italy, Korea and Portugal) as a way to reduce distortions while enhancing revenue.

- *Public sector reform*: reforms to improve the efficiency of government expenditure are a priority for the Czech Republic, Finland, Hungary, Iceland and New Zealand. Increased use of benchmarking is recommended in Finland, Iceland and New Zealand.[11]
- *Public infrastructure*: enhancing the capacity of transport systems – primarily roads – is a priority in four member countries, and this requires better selection of infrastructure projects in Australia, more effective user charges in Ireland and the United Kingdom, and a general upgrading in Poland. Better pricing and management of water and sewage treatment are identified as priorities in Australia and Ireland, while telecommunications infrastructure is a priority in Poland. Infrastructure provision levels are still low in many non-member countries, and an increase in investment is recommended in Brazil and India. While raising spending is an important part of this challenge, a reform of the regulatory environment for infrastructure would help to attract private investment and optimise use, notably in Indonesia.
- *Health care*: improving the cost effectiveness of the health systems is a priority in Switzerland and the United States, with excess expenditure the main challenge. Health care is also a priority for Russia, but the problem to be overcome is that there is low quality and output efficiency, with insufficient funding, weak incentives and poor outcomes.
- *Innovation*: innovation-related reforms boost productivity both by advancing the technology frontier (mainly in advanced OECD economies) and by speeding up the absorption of existing technology (in less advanced OECD and non-member countries).[12] Specific recommendations are made to redirect public funding towards those R&D support programmes that have the highest expected returns (Ireland and Canada), increase R&D tax incentives where they are currently low (New Zealand), improve access to venture capital (Slovak Republic) and strengthen collaborations between academia and industry (Ireland). Broader reforms to the science sector could strengthen innovation and absorption in Russia, while better intellectual property rights enforcement would help improve incentives for investments (often involving technology transfers) in new products in China.
- *Financial services*: Financial market reform is in general not featured among the five priorities and is treated separately, as it is an urgent challenge in many OECD countries that requires broad international co-ordination, as discussed in Box 1.1 and last year's edition of *Going for Growth*. More basic financial liberalisation needs to take place in most non-member economies, including Brazil and India, where bank credit is not fully allocated by the market, and reforms are a priority. However, in order to deliver their full benefits, such liberalisations should be gradual and accompanied by strong prudential regulation.

In non-member countries, a number of additional policy areas stand out as particularly relevant, as highlighted in the 2010 *Going for Growth* special chapter on the BIICS. Beyond the domains already mentioned above – notably product market reform, infrastructure, education, health care, innovation and financial services – some other areas are more important for these countries:

- *Governance and legal reforms*: reform priorities in these areas have been made previously for some OECD countries (*e.g.* Mexico) to strengthen the "rule of law" and clarify property rights. Such a recommendation is a common challenge among many non-member countries, and a strengthening of contract enforcement and some improvement in the effectiveness of courts is recommended in China to improve the predictability of the business environment, and to better protect intellectual property rights. Institutional reforms that would help to fight corruption are advocated for Indonesia and Russia, including a simplification of administrative regulations and a reduction in the extent of bureaucratic discretion.
- *Subsidies*: energy subsidies are sometimes used as social policy devices but they distort markets and waste resources that could more effectively be targeted directly at the poor – such as through cash transfers – or at growth-promoting spending. Phasing out such subsidies is a priority for India and Indonesia in particular.

Beyond the above areas, there may be some policy areas which the exercise does not yet cover which could be of considerable importance for improving living standards in the BRIICS, as discussed in the special chapter in the 2010 edition of *Going for Growth*. The design of the exercise is such that there is a necessary focus on policy areas where quantitative indicators provide coverage, and are thus able to reveal policy priorities. New empirical work that uses aggregate growth regressions to look at a broad range of growth drivers for OECD and BRIICS countries is provided in Bouis *et. al.* (2011). This analysis largely confirms previous OECD findings regarding the sources of growth for a smaller set of OECD countries, and also brings new insights. In particular, the strength of patent rights protection appears to be a robust determinant of long-run productivity levels once controlling for the impact of all other policy and institutional influences. Priority areas may evolve, and new ones emerge in the future as a result of further empirical analyses.

Policies to enhance labour utilisation

Labour market outcomes vary considerably across OECD countries and the BRIICS. The unprecedented recession brought about substantial labour market adjustment everywhere, but developments in both participation and employment rates diverged strongly across countries (Figure 1.3).[13] Indeed, in contrast with earlier recessions, participation rates actually increased in many countries, in part due to the entry of second earners into the labour market, and because seniors delayed retirement owing to a decrease in their pension savings, or to past reforms to both pension and early retirement systems. Nevertheless, there are concerns for youth, who may suffer long-term consequences of unsuccessful labour market entry, and the risk of labour market withdrawal remains for older workers. In fact, as a result of the sizable job losses in many countries (notably the Czech Republic, Greece, Ireland, Portugal and Spain, see Table 1.2), a substantial risk of persistent high unemployment exists. This is also the case in a number of continental EU countries where job losses have been smaller but labour market institutions remain less employment-friendly despite the reforms of recent years (which have followed, to some extent, the *OECD Jobs Strategy*). In some countries, these problems can be compounded with a shift toward the informal sector. *Going for Growth* priorities are mainly aimed at raising labour utilisation over the long term, and many would also help

Figure 1.3. **Labour force participation and unemployment rates**

1. 2008 for Brazil, Indonesia and South Africa and 2007 for China.

Source: OECD (2010), *OECD Economic Outlook No. 88: Statistics and Projections Database* and ILO (International Labour Organisation) (2010), *Key Indicators of the Labour Market (KILM) Databases.*

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Table 1.2. **The estimated vulnerability to an increase in structural unemployment varies by country**

	Change in unemployment rates activity from peak to mid-2010[1]		
Estimated relative sensitivity of structural unemployment to a cyclical increase in aggregate unemployment[2]	No/small unemployment impact *(Less than a 1.5pp increase)*	Medium-small unemployment impact *(At least a 1.5pp increase but less than a 3pp increase)*	Large unemployment impact *(At least a 3pp increase)*
Low	Korea	Canada Mexico New Zealand Sweden	Denmark Iceland United States
Medium	Australia Austria Germany Japan Luxembourg Norway	Finland France Hungary United Kingdom	
High	Switzerland	Belgium Italy Netherlands Turkey	Czech Republic Greece Ireland Portugal Spain

Note: pp: Percentage-point.
1. Peak defined in terms of real quarterly GDP.
2. Based on OECD estimates of how the impact of recessions on structural unemployment is affected by cross-country differences in labour market institutions and policies (see Guichard and Rusticelli, 2010).

Source: OECD calculations based on *OECD Economic Outlook No. 87*, Table 5.2.

alleviate the persistent labour market effect of the crisis. Policy priorities to address labour utilisation include tax policies, the design of social transfer programmes and labour market regulation.

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. High marginal tax rates have also been found to reduce weekly hours worked of second earners (Causa, 2009). Lowering such taxes (including through cuts in social contributions) is a priority for almost half of OECD countries (Australia, Austria, Belgium, the Czech Republic, Denmark, Germany, Greece, Finland, France, Hungary, Israel, Italy, the Netherlands, Norway, Sweden and Turkey).[14] However, given the substantial fiscal challenges that many of these countries face, it will be important for them to pursue efforts in that direction only gradually and along with base broadening, public spending efficiency gains or outright cuts, as well as shifts in the structure of taxation more towards growth-friendly forms of taxation, such as taxes on consumption, immovable property or pollution. Outside of the OECD, labour taxes are generally lower, and thus pose less of a disincentive to work, though they are high enough in Brazil that reducing them is a priority.

Social benefits

Restructuring 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. Embedded features of pension systems – such as the eligibility age for benefits, the extent of actuarial adjustments for early and late retirement and the existence of formal or effective early retirement schemes –have powerful effects on decisions to remain in the labour force. Reforms that move pension systems closer to actuarial neutrality are identified as priorities in Austria, Belgium, Finland, Greece, Hungary, Luxembourg, Slovenia, Spain, Poland and Turkey. Phasing-out early retirement schemes is recommended in Belgium, France, Greece, Luxembourg, Poland and Turkey, and effective retirement ages need to be raised more broadly. However, a tightening of some early exit routes from the labour market risks triggering an increase in the use of others, including disability and sickness benefits. While there was some success in limiting new inflows to these schemes prior to and in the wake of recession, persistently high unemployment will add renewed pressure on systems that do not enforce strict health criteria for eligibility and have insufficient monitoring. Better monitoring of eligibility for disability schemes is a priority in Sweden, while more frequent reviews of work capacity are a priority in the Denmark, the Netherlands, Norway and the United Kingdom.

Unemployment benefit systems have been an important device for mitigating the income losses caused by the crisis, and several OECD countries extended coverage, raised the level and/or lengthened the duration of benefits, especially where these were comparatively low. However, too-high or long-lasting unemployment benefits reduce job-search incentives and can raise wages above market-clearing levels, thereby increasing structural unemployment. Unemployment insurance reform is a priority in Belgium, Canada, Finland, the Netherlands and Portugal. In these countries, stricter limits on benefit duration or a reduction in their level over the unemployment spell are recommended. Relatively generous unemployment benefits can also be made more consistent with low unemployment through well-designed active labour market programmes and strong job-search requirements. This may be particularly important in view of the labour reallocation needed in wake of the crisis. A revision of these activation policies to strengthen their effectiveness is a priority in Estonia, Ireland, Israel and Luxembourg.

Beyond tax policies and the design of benefit systems, broad access to childcare and appropriate parental leave policies are important to facilitate female labour force participation. A strengthening of childcare programmes and related policies is a priority for Australia, Chile, Ireland, Korea, the Slovak Republic and Switzerland.

Labour market regulation and wage policies

Poorly designed labour market regulations create duality in the labour market, which refers to the existence of separated segments where comparable workers enjoy differential wage and protection treatment. In particular, duality often results from excessive gaps in job protection between permanent and temporary contracts. This hampers employment of certain groups (*e.g.* young people) and overall productivity (OECD, 2006b; Bassanini *et. al.*, 2009). Further reforms to reduce labour market duality through a reduction in the protection of permanent jobs are a priority in Chile, the Czech Republic, France, Germany, Italy, Japan, Korea, the Netherlands, Portugal, Spain, Slovenia and Sweden. Easing very stringent restrictions on temporary contracts is a priority in Luxembourg and Turkey. Collective dismissal provisions are also a problem in India, where larger plants face especially onerous *pro forma* requirements. To tackle the problem of informality, simplifying dismissal procedures and reducing severance payments is identified as a priority in Indonesia. The positive effects of job protection reforms can be further reinforced through concomitant introduction or appropriate strengthening of unemployment benefit or insurance systems where these are little developed, as recommended for Chile and Indonesia.

High minimum labour costs, which can result from a combination of high legal minimum wages and/or labour taxes, can further limit the jobs available for young workers and the low-skilled. This can also be a problem in countries with informality problems, although minimum wages can also help attract workers to the formal sector. In order to address excessive labour costs, France, Greece, Indonesia, Slovenia and Turkey should limit the increase in their minimum wages.

The cost of labour is also driven up by collective wage agreements that in some countries are administratively extended to workers and employers who are not party to the original settlements, leading to too-high labour costs for some employers (who may sometimes be in different sectors and regions) and reducing competitive pressures from the entry of new firms. Greater flexibility in wage determination is a priority in Belgium, Italy, Slovenia and Spain. In South Africa, a greater degree of coordination of wage bargaining could help to raise the very low employment rate in the formal sector.

The contribution of structural reforms to fiscal sustainability

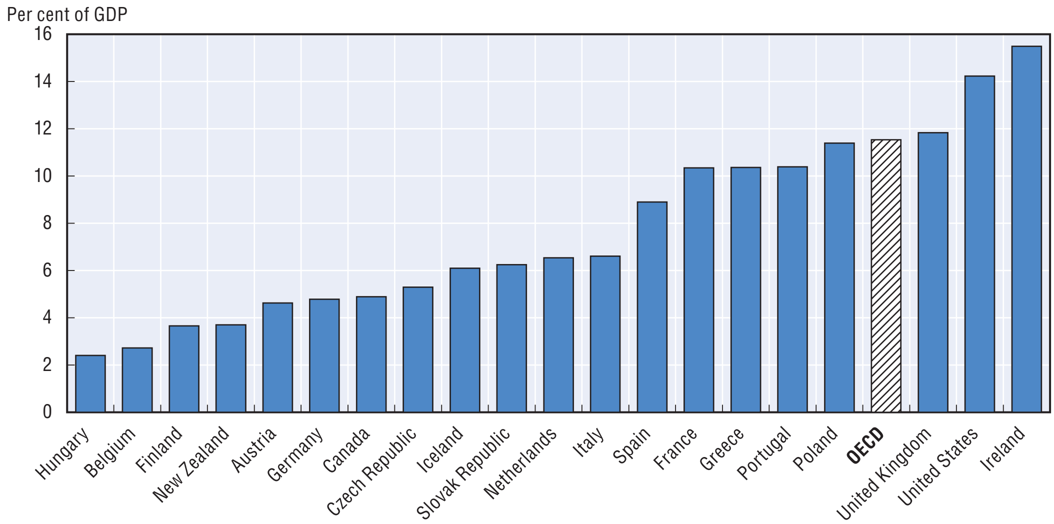
The structural reforms recommended in *Going for Growth* are directed at improving long-term levels of GDP per capita. However, most reforms have important side effects that could improve or worsen fiscal balances. This is of particular importance at the present juncture given the wide post-crisis fiscal deficits. Against that background, this section examines the extent of co-benefits for public budgets from various structural reforms to boost long-term output.

Fiscal deficits loom large

Fiscal deficits and government debt are approaching record levels. Fiscal deficits are estimated to have amounted to 8% of GDP in OECD countries in 2010 – more than three-quarters of which is estimated to be structural – and debt-to-GDP ratios will continue to rise across the OECD area, exceeding 100% of GDP on average in 2011 (OECD, 2010c). This rising indebtednesses in OECD countries could jeopardize future income growth, directly through its effects on long-term interest rates and the ability to counteract future crises, and indirectly by making political support for growth-friendly reforms more difficult (Duval, 2008; Tompson and Dang, 2010). Reduction of fiscal deficits is therefore a crucial policy challenge for OECD countries. A stylised extension to 2025 of OECD's short-term projections (OECD, 2010c, Chapter 4) has been used to assess the extent of consolidation needed to reduce debt-to-GDP ratios by 2025. The scenario assumes that from 2012 onwards there is a gradual and sustained improvement in the underlying primary balance until the debt-to-GDP ratio is reduced to 60% of GDP in each country.[15, 16] Measured against this criterion, the extent of consolidation needs varies widely across the OECD, with three groups of countries emerging (Figure 1.4):[17]

- *Very large fiscal consolidation needs* (more than 6% of GDP relative to 2010): the reduction of the debt-to-GDP ratio would call for an increase in underlying primary balances of more than 10% of GDP in Greece, France, Ireland, Japan, Poland, Portugal, the United Kingdom and the United States. The required change ranges from 6% to 10% of GDP in Iceland, Italy, the Netherlands, Spain and the Slovak Republic.
- *Moderate to large fiscal consolidation needs* (lower than 6% of GDP relative to 2010): the reduction of the debt-to-GDP ratio would require an increase of underlying primary balances of less than 4% of GDP for Belgium, Finland, Hungary and New Zealand. The need for fiscal consolidation ranges from 4% to 6% in Austria, Canada, the Czech Republic and Germany.

Figure 1.4. **Required improvement in the underlying primary deficit (from 2010 onwards) to achieve a debt-to-GDP ratio equal to 60% of GDP by 2025**[1]



1. The chart shows the total consolidation effort required to achieve a gross general government debt-to-GDP ratio equal to 60% of GDP by 2025. It assumes a constant improvement in the underlying primary balance each year between 2013 and 2025, calculated so as to achieve the debt target in 2025 and based on the improvement projected in each country between 2010-12. The required consolidation effort for Japan to achieve a debt ratio of 60% of GDP is not shown because it would call for a very large degree of tightening if this were to be achieved by 2025.

Source: OECD (2010), *OECD Economic Outlook No. 88*, Vol. 2010/2.

StatLink http://dx.doi.org/10.1787/888932372868

- *Low fiscal consolidation needs*: a third group of countries has comparatively low fiscal consolidation needs. Within the OECD, countries such as Australia, Denmark, Korea, Luxembourg, Norway, Sweden and Switzerland do not need to implement fiscal consolidation in order to achieve the 60% debt-to-GDP ratio in 2025, due to their more favourable initial conditions.

Public finances in the BRIICS and new OECD members are also generally more sustainable than in most OECD countries, reflecting the comparatively low level of their debt-to-GDP ratios, their moderate primary deficits and/or their relatively strong growth prospects. This is especially the case for China and Indonesia where the general government debt is below 30% of GDP and fiscal deficits are small (respectively, 1.2% and 1.6% of GDP in 2009). South Africa and Russia have comparatively higher headline deficits (amounting to respectively 7.6% and 5.3% of GDP) but also enjoy debt-to-GDP ratios below 30%.[18]

Structural reform can assist consolidation

Given the size of fiscal imbalances and the need to preserve confidence and credibility, many OECD countries appropriately plan to begin a process of consolidation from 2011. Such efforts could be aided by the implementation of structural reforms. Generally, structural measures that raise potential output through higher labour utilisation are likely to contribute more to fiscal consolidation than measures which work through the productivity channel. Higher employment is often associated with higher tax revenue and lower public spending on benefits. Overall, a 1 percentage point improvement in potential employment through structural reforms would improve the fiscal position across OECD countries by between 0.3 to 0.8 points of GDP (OECD, 2010c). Higher productivity is likely to be reflected into higher public sector wages or higher social benefits,[19] and therefore to deliver comparatively smaller fiscal gains. Historical experience also suggests that fiscal consolidation is more likely to be achieved through cuts in spending than raising taxes, possibly because this demonstrates commitment and strengthens the credibility of the consolidation strategy (Alesina and Ardagna, 2009; Guichard *et. al.*, 2007).

Although fiscal consolidation should not be obtained by compromising long-term growth-friendly structural reforms, the magnitude of the immediate fiscal challenge in some countries may still constrain reform choices in practice. Countries with large fiscal consolidation needs (*e.g.* Ireland, Japan, Poland, Portugal, the United Kingdom and the United States) may be forced to favour policies that are likely to directly improve their fiscal balances over the coming years. Consequently, they may give priority to reforms which boost employment and reduce public spending at the same time. By the same token, these countries have less room to boost public spending on productivity-enhancing areas like education, innovation and infrastructure – which of course does not imply that progress cannot be made in these areas through other means.

Overall, six stylised categories of structural reforms can be distinguished depending on their effect on fiscal positions (positive directly or indirectly, or negative) and on whether they boost long-term GDP per capita by raising employment or productivity (Table 1.3).[20] Four of these categories, which are reviewed in detail below, could contribute to both raise long-term living standards and consolidate public budgets. These are reforms that would enhance fiscal positions either directly, by reducing public spending, or indirectly, by gradually increasing tax receipts through higher productivity and – especially – employment. Reforms that ultimately increase productivity and/or employment, but would first weaken fiscal positions by increasing growth-friendly public spending (*e.g.* on innovation, infrastructure or education) or by reducing tax receipts (*e.g.* tax wedge cuts) are not discussed below. Their cost for public budgets would only gradually and partially be reduced as they deliver their benefits for productivity and employment.

Reforms that increase employment and directly improve fiscal positions

Reforms of disability, sickness and unemployment benefit schemes, as well as of old-age pension systems and *de facto* early retirement schemes could contribute to immediately improve fiscal balances while fostering employment and thereby raising tax revenues in the longer term. Such reforms include *inter alia* tighter eligibility criteria to disability benefits, cuts in the level and/or duration of unemployment benefits or increases in minimum retirement ages. Such reforms are identified as key priorities in almost three-quarters of the 40 countries considered in *Going for Growth*.[21] The crisis has already led to an increase in labour force participation in a number of countries, which reforms in these areas could help consolidate. Phasing out crisis-related increases in benefit levels and/or duration (where these were already high) as unemployment goes down would also raise labour utilisation with direct co-benefits for public budgets. By contrast, some of the recent extensions in the coverage of unemployment benefits in countries where systems did not previously cover an important share of the workforce, – particularly temporary workers – could be made permanent.

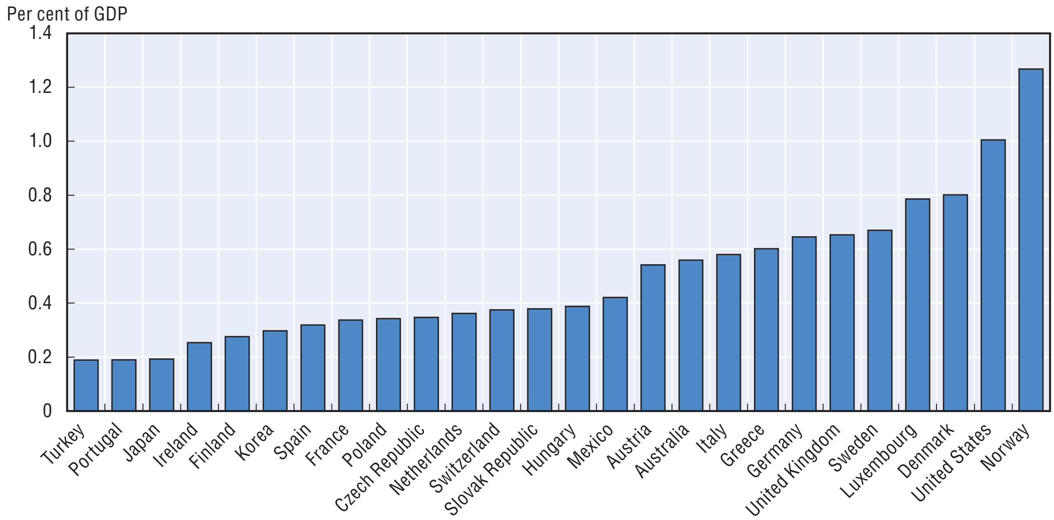
Table 1.3. **Fiscal impact of various types of growth-enhancing structural reforms**

A. Reforms that directly improve fiscal positions	
Productivity-enhancing reforms	Improve public spending efficiency in particular in:
	Health care
	Education
	Reduce the scope of state control
	Reduce public subsidies (producer support to agriculture, energy subsidies)
	Reduce housing subsidies
	Implement taxes on negative externalities such as pollution (e.g. carbon emission pricing, green taxes)
Employment-enhancing reforms	Reconsider schemes undermining incentives to work
	Monitor better the disability and sickness benefits schemes
	Reduce unemployment benefits levels and/or duration
	Phase out early retirement schemes and/or increase legal retirement age
B. Reforms that improve fiscal positions only indirectly	
Productivity-enhancing reforms	Relax product market regulation
	Ease entry restrictions in non-manufacturing sectors
	Reduce barriers to entrepreneurship
	Reduce barriers to trade and FDI
	Implement revenue-neutral changes in tax structure
	Increase the share of consumption and property taxes and reduce the share of corporate and labour income taxes
	Broaden the tax base and cut the tax rate
Employment-enhancing reforms	Relax employment protection legislation
	Reduce legal minimum wages where high and/or for specific groups
	Relax product market regulation
C. Reforms that are likely to weaken fiscal positions at least in the short run	
Productivity-enhancing reforms	Increase public spending on innovation, education, infrastructure
	Reduce international trade barriers (tariffs)
Employment-enhancing reforms	Increase public spending on active labour market policies
	Reduce the tax wedge on labour income

Reforms that increase productivity and directly improve fiscal positions

Efficiency gains in public spending.[22] Public spending efficiency is a key policy area where reforms could allow for reduced expenditure, while maintaining or even increasing outputs.[23] In particular, improving the efficiency of education systems is a key policy objective in almost all OECD countries and the BRIICS.[24] Recent OECD analysis suggests that substantial fiscal resources could potentially be saved in underperforming countries through the gradual adoption of best practices in primary and secondary education, which as a whole currently cost about 3% of GDP on average in OECD countries (Sutherland *et. al.*, 2007).[25] The estimated potential cost savings with no prejudice to education outcomes amount to 0.2% to 0.4% of GDP for most countries, even reaching 0.6% to 1.3% of GDP for Denmark, Germany, Luxembourg, Norway, Sweden, the United Kingdom and the United States (Figure 1.5). Reforms in this area may include *inter alia* the possibility for pupils and/or their families to choose between schools (therefore making schools more responsive to needs), a definition of performance objectives for public educational institutions along with incentives to reach them, and a decentralisation of responsibilities for primary and secondary education to sub-central governments (OECD, 2008, Chapter 4).

Figure 1.5. **Potential cost savings (public and private) from efficiency gains in primary and secondary education at the national level**[1, 2]



1. Potential savings represent the difference between a no-reform scenario and a scenario where all schools in each country would become on average as efficient as those in the best performing country. Estimates of efficiency are based on DEA analysis at the national level with two outputs (average Programme for International Student Assessment – PISA score and homogeneity of PISA score) and two inputs (teachers per 100 students and socio-economic background of students).
2. Potential input cuts applied to compensation of all staff in primary, secondary and post-secondary non-tertiary education in 2002.

Source: OECD calculations; OECD (2005), *Education at a Glance, OECD indicators 2005.*

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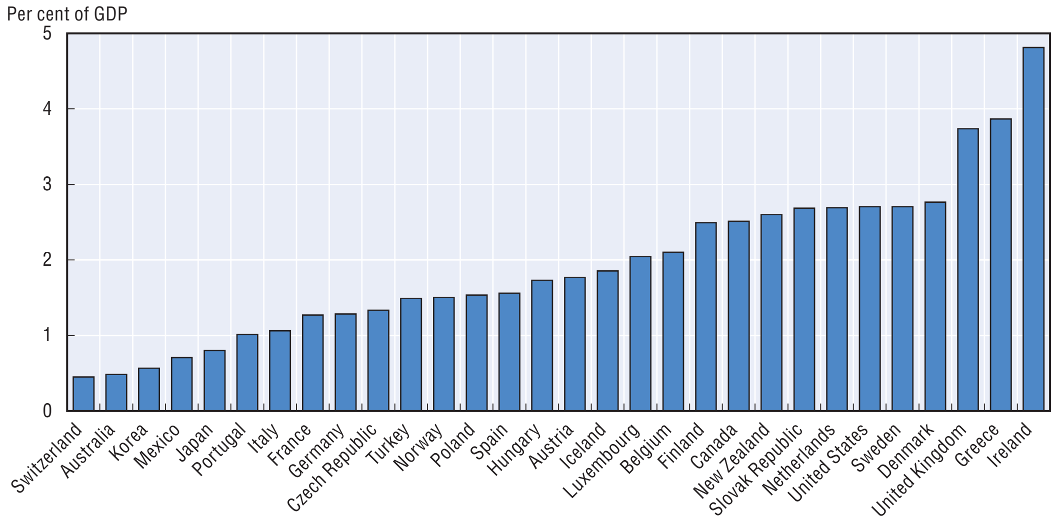
Improving health care sector efficiency could deliver even larger fiscal gains, and it appears as a key priority for the Czech Republic, Russia, Switzerland, the United Kingdom and the United States. More generally across OECD countries, efficiency gains hold the promise of sizeable cost savings given that overall health care spending accounts for about 9% of GDP on average (6% when considering only public spending). Potential savings are estimated here as the reduction in public spending that could be achieved by moving towards the efficiency levels of best-performing countries while improving health outcomes – as measured by life expectancy gains – at a similar pace as over the past decade.[26] Such savings in public expenditure could amount on average to about 2% of GDP, and they appear particularly sizeable for Greece, Ireland and the United Kingdom (Figure 1.6).

Pricing pollution and reducing public subsidies and tax expenditures. Cost-effective policies to address public "bads" such as pollution could also enhance welfare – although not GDP per capita – while assisting fiscal consolidation. Pollution pricing mechanisms such as green taxes or auctioning of emission permits should generally be preferred to green subsidies, as the latter increase budget deficits and are not cost-effective tools to address environmental issues more broadly. Revenues from environmental taxes vary widely across countries (Figure 1.7). They remain low in countries such as Canada, Chile, New Zealand or the United States, implying some apparent scope for raising further revenues from this source. In particular, the potential fiscal revenues from pricing greenhouse gas emissions is sizeable, and has been evaluated for instance at 2.5% of GDP on average by 2020, if all industrialised countries were to use domestic carbon taxes or auctioned emission trading permits to reduce emissions in each of them by 20% relative to 1990 levels (De Serres *et. al.*,

Figure 1.6. **Potential fiscal gains from efficiency improvements in health care systems**[1]

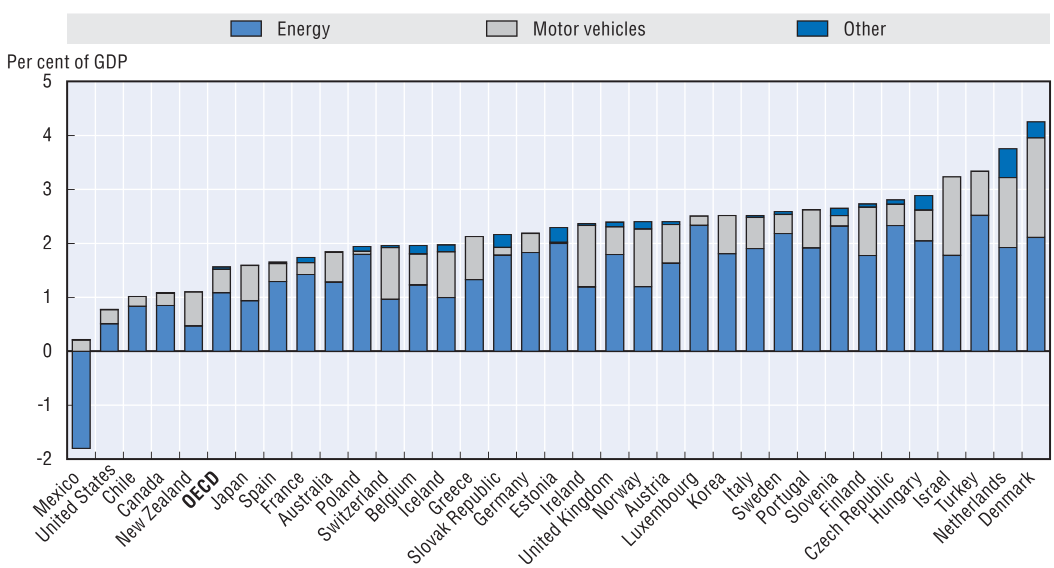


1. Potential savings represent the difference between *i)* a scenario where public spending and life expectancy gains would increase at the same pace over the next decade as over the decade 1997-2007 and *ii)* a scenario where countries would achieve similar health improvements with lower public spending by moving towards the efficiency levels of best-performing countries.

Source: See Chapter 4; OECD estimates based on Joumard *et. al.* (2008), "Health Status Determinants: Lifestyle, Environment, Health Care Resources and Efficiency", *OECD Economics Department Working Papers*, No 627.

StatLink http://dx.doi.org/10.1787/888932372906

Figure 1.7. **Revenues from environment-related taxes, 2008**



Source: OECD/EEA Database on instruments used for environmental policy.

StatLink http://dx.doi.org/10.1787/888932372925

2010). In the EU, the planned gradual auctioning of emission permits is expected to raise a growing amount of revenues from 2013. Opportunities to raise additional receipts emerge also from the existence of disparities in environmental-related tax rates within countries

(OECD, 2009c). Such disparities reduce the efficiency of green taxation as they do not generally reflect differences in the magnitude of negative externalities.

Public subsidies, when not addressing market failures, distort resource allocation and hurt productivity. Subsidies across the OECD range from about 0.1% of GDP in Greece to 3.9% of GDP in Switzerland.[27] Reducing producer support to agriculture is identified as a country-specific priority in the EU, Iceland, Japan, Korea, Norway, Switzerland and the United States; reducing subsidies to energy appears as a recommendation in Indonesia, and phasing out housing subsidies (or tax expenditures in this area) is a priority in Denmark and Luxembourg.

While difficult to quantify, tax expenditures have probably increased over time, notably in order to address market failures or income redistribution concerns, and may now be very large, possibly reaching close to 20% of total tax revenues in Italy and the United States and 30% in the United Kingdom (OECD, 2009c). When an alternative cost-efficient way to reach the same objective exists, removing them is recommended as they need to be offset by other taxes and thereby generally increase distortions in the tax system (OECD, 2010h). Tax expenditures also make tax compliance more difficult. Improving the effectiveness of tax administrations in tax collection and the fight against tax evasion is another way to both enhance tax efficiency and reduce fiscal deficits, and the amounts of tax revenues involved can be significant.

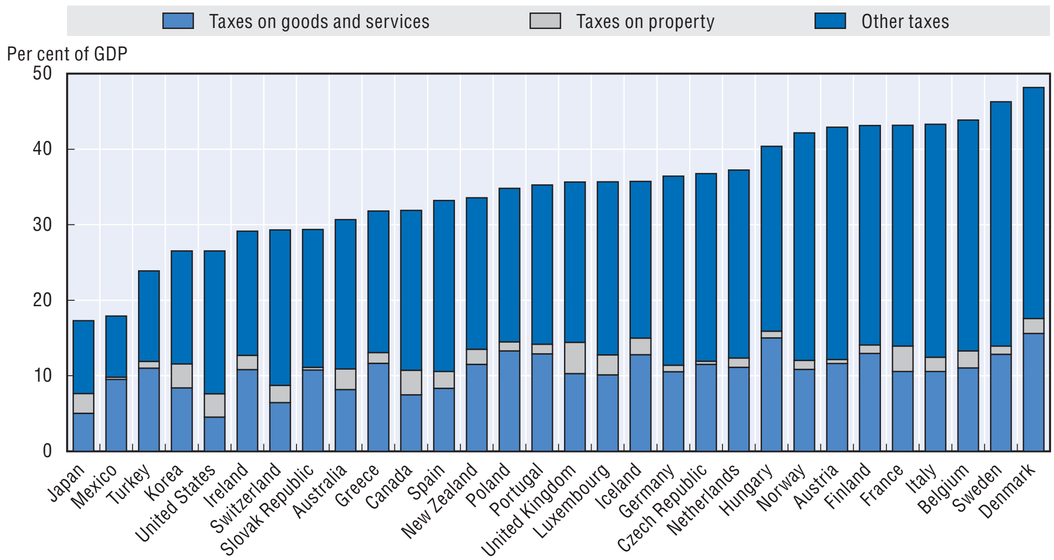
Structural reforms that could improve fiscal positions indirectly

Product market reforms are mostly fiscally-neutral in the short term and are likely to contribute to a reduction of fiscal deficits in the medium term by increasing productivity – as well as employment – and therefore tax revenues. This productivity effect could be particularly important for lower-income OECD members and the BRIICS, where the stringency of regulations in product markets and thus the scope for productivity gains are particularly high, but fiscal deficits are low in most of them.[28] Product market reforms are recommended in the vast majority of countries.[29]

Even if revenue neutral, tax reforms can also make some indirect contribution to fiscal consolidation through their medium term effects on income, productivity and tax receipts. For most OECD countries, recent empirical evidence points to significant impacts on productivity and investment from changes in tax structure involving lower personal and corporate income taxes offset by higher consumption and property taxes, as well as from tax-base broadening accompanied by lower marginal tax rates (see Arnold and Schwellnus, 2008; Johansson *et. al.*, 2008; OECD, 2010h). Among the sixteen countries with a recommendation in this area, there is more room for changes in countries where these indirect taxes are not predominant such as in Austria, Belgium, France, Germany, Italy, Japan, Norway, Sweden and the United States (Figure 1.8). In several countries, broadening tax bases would further enhance the efficiency of the tax system by enabling a reduction in tax rates and by cutting economic distortions and administrative compliance costs associated to tax expenditures. This has been identified as a key priority in Austria, Belgium, Greece, Italy, Korea, Portugal and the United States.

Higher flexibility in wage bargaining, a reduction in minimum labour costs or job protection reform to address labour market dualism could help to enhance the job opportunities of specific underemployed groups of the labour force such as young people and the low-skilled. Insofar as overall employment increases, such reforms would

Figure 1.8. **Tax revenue as a share of GDP, 2008**[1]



1. 2007 for Australia, Belgium, Mexico, the Netherlands and Poland.

Source: OECD (2010), *Tax Revenue Database*.

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indirectly contribute to fiscal consolidation, as higher employment implies more taxes and less spending over the medium run. Labour tax wedge cuts offset by increases in other taxes could have the same effect. The need for such labour market reforms has been diagnosed as a priority in 19 countries,[30] while tax reforms involving labour tax cuts have been recommended in 16 countries.[31]

Table 1.4 sums up the potential co-benefits for fiscal positions from addressing the revised *Going for Growth* priorities. It reports the number of reform priorities that would directly and quickly improve the fiscal balance, and also provides for most OECD countries the potential cost savings that could be reaped by moving national education and health care systems to best practice. It turns out that many of the revised *Going for Growth* priorities could, if addressed, make a significant contribution to fiscal consolidation in most OECD countries. Education and health reforms would further strengthen those fiscal gains.

Effects of structural reforms on current account imbalances

The structural reforms recommended in *Going for Growth* may have important side effects on global current account imbalances which remain large (Figure 1.9) despite some shrinking during the crisis. Addressing these imbalances can enhance global financial stability, and as such it has been one of the main focuses of the G20 framework for strong, sustainable and balanced growth launched by G20 leaders at the Pittsburgh Summit in 2009. Even if it is not their main objective, structural policies may affect current account positions through their effect on the saving and investment decisions of households, firms and governments.

Current account imbalances and fiscal consolidation

Fiscal consolidation programmes implemented in most OECD countries – the magnitude of which tends to be larger on average in external deficit countries, possibly aided by the type of structural reforms discussed in the previous section, may contribute to

Table 1.4. **Potential impact of structural policies on fiscal positions**

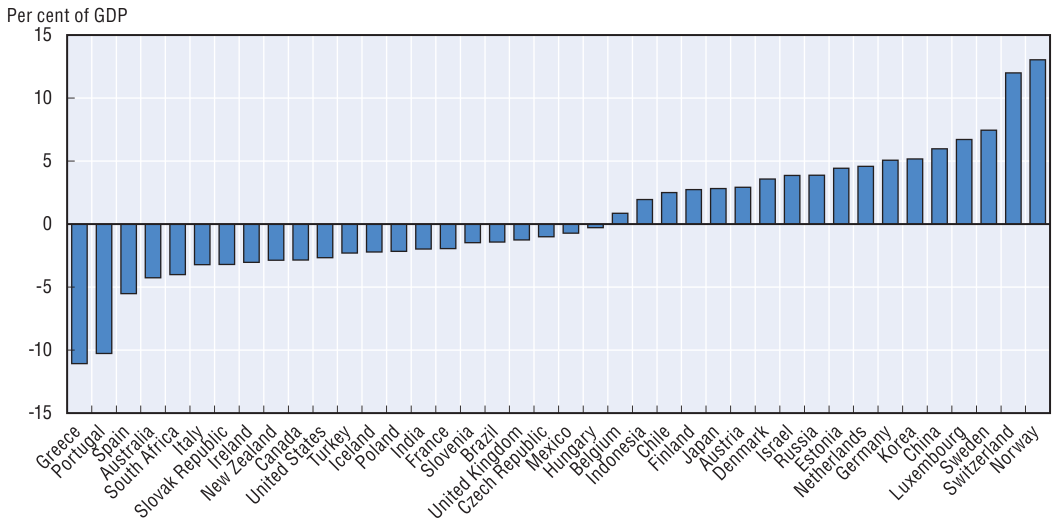
Countries	Net number of priorities with positive fiscal-side effects	Potential cost savings from increasing efficiency in the health care system (% of GDP)	Potential cost savings from increasing efficiency in the education system (% of GDP)
Australia	0	0.5	0.6
Austria	+++	1.8	0.5
Belgium	+++	2.1	n.a.
Canada	0	2.5	n.a.
Czech Republic	++	1.3	0.3
Denmark	++++	2.8	0.8
Finland	++++	2.5	0.3
France	++	1.3	0.3
Germany	++	1.3	0.6
Greece	++	3.9	0.6
Hungary	+++	1.7	0.4
Iceland	++++	1.9	n.a.
Ireland	0	4.8	0.3
Italy	++	1.1	0.6
Japan	++	0.8	0.2
Korea	0	0.6	0.3
Luxembourg	+++	2.0	0.8
Mexico	+	0.7	0.4
Netherlands	++	2.7	0.4
New Zealand	++	2.6	n.a.
Norway	++++	1.5	1.3
Poland	++	1.5	0.3
Portugal	++	1.0	0.2
Slovak Republic	++	2.7	0.4
Spain	++	1.6	0.3
Sweden	+++	2.7	0.7
Switzerland	+++	0.5	0.4
Turkey	++	1.5	0.2
United Kingdom	+++	3.7	0.7
United States	+++	2.7	1.0
Brazil	0	n.a.	n.a.
Chile	–	n.a.	n.a.
China	+	n.a.	n.a.
Estonia	0	n.a.	n.a.
India	0	n.a.	n.a.
Indonesia	0	n.a.	n.a.
Israel	0	n.a.	n.a.
Russia	+	n.a.	n.a.
Slovenia	++++	n.a.	n.a.
South Africa	0	n.a.	n.a.

Note: The first column reflects the sum of priorities that are likely to directly improve the fiscal position minus the number of priorities that are expected to weaken it. For example, (+++) indicates that three priorities (net of deficit-augmenting priorities) are likely to improve the fiscal balance.

narrowing the gap for deficit economies by increasing their overall saving rates. More generally, beside their impacts on the fiscal deficit, growth-friendly structural reforms may be considered in light of their direct effects on saving and investment behaviour. Results from new OECD empirical analysis (see Chapter 5 in this edition) help identify the side effects of structural policies on current accounts (Table 1.5):

- Many structural reforms affect current account imbalances by boosting productivity growth, which empirically is associated with a negative impact on the current account

Figure 1.9. **Current account balance, 2009**



Source: OECD (2010), *OECD Economic Outlook No. 88: Statistics and Projections Database*.

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position, at least over a short to medium-term horizon.[32] This works notably through a higher investment rate, possibly reflecting the higher rate of return associated with productivity gains, which appears to more than offset possible positive effects on aggregate saving. This negative impact of productivity growth increases on current accounts tentatively suggests that many productivity-enhancing reform priorities identified in this edition of *Going for Growth* could contribute to reduce external imbalances in surplus countries.

- The empirical analysis in Chapter 5 suggests that, over and above its indirect effect through higher productivity growth, removing anti-competitive regulations in product markets could directly boost private investment, and thereby further reduce the current account position of surplus countries.[33] For instance, aligning the level of product market regulation in Japan and Germany – where reform is identified as a priority in this area – with OECD best practice could raise private investment in these countries by 0.6 and 0.7 percentage points of GDP in the short term, respectively.

In (most) emerging economies, introducing and/or scaling up social welfare systems would help citizens cope with various eventualities and therefore, as a side effect, help reduce excess precautionary saving and thereby weaken current accounts:

- According to recent OECD estimates, financed increases in social spending on health by 1 percentage point of GDP in OECD countries could on average reduce private saving by about 1.5% of GDP. The effect may be even higher for countries with low initial levels of social spending, possibly reaching 2½ per cent of GDP for China for instance, although there is wide uncertainty around this estimate. In the case of China, insofar as sustained increases in social spending remained unfinanced, they would prevent the expiry of recent fiscal stimulus from leading to a rise in public saving and the current account could weaken further.
- Reforms that aim to improve the sustainability of public pension schemes in industrialised economies by delaying the standard retirement age may help to reduce life-cycle saving in surplus countries: OECD estimates suggest that an increase in the

Table 1.5. **Overview of the estimated impact of some structural policies on saving, investment and the current account**

	Total saving	Total investment	Implied effect on current account	Countries where the external imbalance could be reduced by addressing the corresponding priority
Increase in productivity growth	+	+	–	All current account surplus countries
Product market reform		+	–	Belgium, China, Chile, Estonia, Germany, Denmark, Israel, Indonesia, Japan, Korea, Luxembourg, Norway, Russia, Switzerland
Improvement in coverage/quality of social welfare system	–		–	Switzerland, Russia
Increase in statutory retirement age	–		–	Finland, Belgium
Lowering of employment protection for regular workers	0	–	+	the Czech Republic, France, India, Italy, Portugal, Spain, Slovenia, Turkey
Financial market reform	0/–	0/+	0/–	

Note: Based on the OECD estimates featured in the special chapter (Chapter 5) on this topic. The reported results refer to the medium- to long-run effect in all cases but PMR reform, where the short-run effect is shown. The identification of surplus and deficit countries is based on 2009 data.

statutory retirement age by one year could reduce total and private saving by around ½ percentage point of GDP in the medium to long run.

- Reforms of employment protection legislation do not appear to have any clear-cut side effects on saving behaviour, but relaxing job protection seems to strengthen current accounts through a decline in investment, possibly because firms substitute labour for capital as labour markets become more flexible. EPL reform might for instance contribute to reduce current account imbalances within the euro area, since it appears as a priority in France, Italy, Portugal, Slovenia and Spain.
- Financial market liberalisation, especially in emerging countries where it often implies curbing financial repression, should help to relax borrowing constraints for households and firms. Indeed, some estimates reported in the special chapter (Chapter 5) suggest that such reforms could reduce saving especially in less advanced economies. Investment may also rise, further weakening the current account.

Overall, these findings, together with the effects of structural reforms on fiscal balances discussed above suggest that a good number of the revised *Going for Growth* priorities could, if addressed, not only enhance living standards but also contribute to more balanced fiscal and/or current account positions (Annex 1.A2).[34]

Notes

1. See Annex 1.A1 for the methodology used to select policy priorities and Annex 1.A2 for the list of recommendations for each country. As described in previous editions of *Going for Growth*, three priorities are selected using internationally comparable indicators of policy and performance, while two priorities are selected using indicators when available as well as country-specific expertise. Note that while the reforms discussed in this volume are systematically limited to five per country, in many cases, structural reforms in other areas are also needed.
2. 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.
3. The BRIICS grouping includes Russia, which is in the process of accession to the OECD, and the five countries that have enhanced engagement with the OECD: Brazil, China, India, Indonesia and South Africa.

4. Broader measures of well-being are under development as part of the OECD's Global Project on Measuring the Progress of Societies, in part following up on the findings of the Stiglitz-Sen-Fitoussi Commission. While many alternative well-being measures are highly correlated with GDP per capita (see OECD, 2006a), broader measures may be important complements to evaluate issues such as, for example, income distribution, poverty, or environmental sustainability.
5. In last year's edition of *Going for Growth*, a broader measure of GDP that incorporates terms of trade effects was explored. This year, incorporating household production into GDP measurement is examined (Annex 1.A3).
6. Because financial reform requirements are general among countries and need to include some degree of international co-ordination, they are not systematically considered among country priorities but treated in Box 1.1.
7. The decomposition is based on 2009 data. Since then, all countries – and Greece and Iceland even more than others – have been adversely affected by macroeconomic shocks.
8. Annex 1.A2 summarises the five priorities for each country.
9. This was the case for instance with the tax 2001 reform in the Netherlands (Brys, 2010). The Swedish 1991 reform was also the object of a major evaluation exercise (Agell *et al.*, 1996).
10. Because on balance most of the housing recommendations refer to the productivity channel, they are presented in the current section.
11. In Finland the efficiency of municipalities could also be improved through mergers and budget consolidation.
12. 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 enhancing durably productivity growth (OECD, 2010g).
13. Cross-country differences in the response of average hours worked reflect a number of features including collective bargaining and policy settings. Stricter job protection, more flexible hours averaging rules and in some cases collective bargaining agreements tend to encourage working-hours adjustment. Many countries, especially in Europe, have also encouraged employment retention by introducing or scaling-up often generous short-time working schemes (see OECD, 2010b, Chapter 5).
14. More specifically, reforms aiming to reduce social security contributions appear as a priority in Brazil, Germany, Hungary and Turkey.
15. An alternative scenario has been simulated where the extent of consolidation needed just to stabilise the debt-to-GDP ratios at current levels is assessed. The extent of total fiscal consolidation needs is much lower in this case: 5¼ per cent GDP for the OECD as a whole against 11½ per cent of GDP when the debt-to-GDP ratio is required to reach 60%. However, a scenario under which debt-to-GDP ratios are stabilised at current levels rather than reduced would still leave some countries with very high debt levels, of over 100% of GDP over the 2025 horizon (OECD, 2010c).
16. Countries with current debt below 60% are classified as having low consolidation needs according to the stylised scenario used here, but they should still pursue prudent fiscal policies with a view to maintaining longer-term sustainability.
17. This scenario does not include the effects on public budgets of population aging and continued upward pressures on health spending. In the typical OECD country, preventing or offsetting these spending pressures requires cumulative measures amounting to ¼ per cent of GDP per year over the coming 15 years just to keep the underlying primary deficit unchanged, although it might be slightly less on average for the larger OECD countries (OECD, 2010c).
18. OECD (2010c); IMF (2010a).
19. If benefits are not adjusted to productivity gains, this would imply a fall in the replacement rate.
20. The classification of reforms according to whether they primarily raise employment or productivity is stylised and reflects the main channel through which they are expected to increase GDP per capita. In practice, however, a number of reforms (*e.g.* a relaxation of anti-competitive regulations in product markets, a reduction in job protection of regular contracts) can have both employment and productivity effects.
21. Only China, Czech Republic, Germany, Iceland, India, Indonesia, Italy, Japan, Mexico, New Zealand, Slovak Republic, Spain, Russia and the United States do not have country-specific priorities in this area.

22. The indicators used in this section have not been used for the purpose of setting countries' priorities because there are currently no plans to update them on a regular basis, which would be necessary for their regular use in the *Going for Growth* process.

23. Improving efficiency in the public sector could increase productivity not only in the public sector but also in the private sector, for instance to the extent that the latter consumes services produced by the former.

24. Nine of forty countries, *i.e.* Belgium, Canada, Estonia, Ireland, Japan, Korea, Luxembourg, the Netherlands and Russia, do not have priorities in this area.

25. Given the uncertainty surrounding the potential efficiency gains from reforms of education systems, these estimates should however be taken with caution. There is similar uncertainty around the estimates of the fiscal gains from reforms of health systems discussed below.

26. The efficiency gains shown in Figure 1.6 are not strictly comparable across countries as they depend on the projected gains in life expectancy, which are country-specific as they are assumed to reflect a continuation of past trends. For more details, see Chapter 6 on the efficiency of health care systems across the OECD.

27. It should be noted that the total level of subsidies is likely to be higher than reported in national accounts because these do not record tax expenditures and cover a narrow scope (by excluding for instance capital investment grants). See OECD (2010c).

28. There is however tentative evidence that the marginal productivity gains from product market reforms are larger for industries/countries that are closer to the technological frontier, implying that a given decrease in the level of product market regulation may have a lower impact in lower-income countries (Bourles *et al.*, 2010).

29. They are actually recommended in all but five of the 40 countries covered: Finland, the Netherlands, Sweden, the United Kingdom and the United States.

30. Belgium, Chile, Czech Republic, France, Germany, Greece, India, Indonesia, Italy, Japan, Korea, Luxembourg, the Netherlands, Portugal, Slovenia, South Africa, Spain, Sweden and Turkey.

31. Austria, Australia, Belgium, Brazil, Denmark, Finland, France, Germany, Greece, Hungary, Italy, the Netherlands, Norway, Poland, Sweden and the United States.

32. This finding is at odds with some previous research which points out that an economy characterised by a relatively low growth rate tends to characterised by a low income elasticity for its exports and high income elasticity for its imports, implying that demand and productivity effects might cancel out and leave current account positions and real exchange rates unchanged (Krugman, 1989).

33. Current account adjustment to productivity shocks also depends on whether these occur in the tradable or non-tradable sectors, with a larger deterioration to be expected in the former case (Dornbusch, 1983).

34. Regarding external imbalances, this analysis is largely consistent with results from the first stage of the G20 Mutual Assessment Process that were put forward by the IMF with OECD input presented at the June G20 meeting in Toronto (IMF, 2010b).

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ANNEX 1.A1

How Policy Priorities are Chosen for Going for Growth

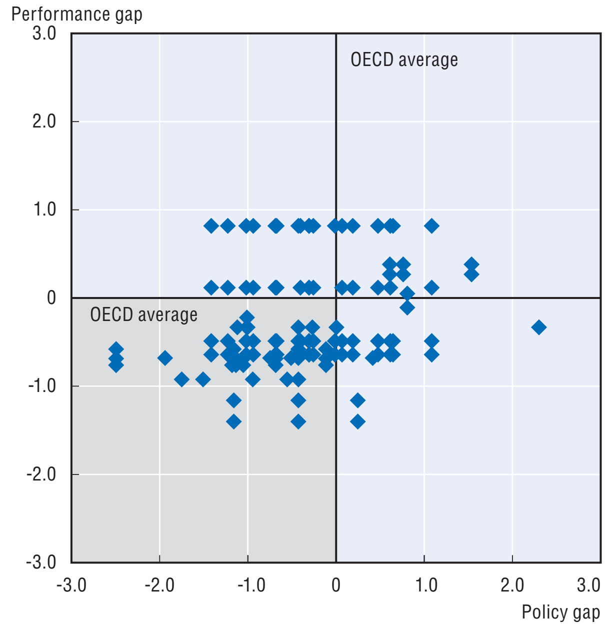
The *Going for Growth* structural surveillance exercise seeks to identify five policy priorities for each OECD member country, the BRIICS and the EU. Three of these policy priorities are identified based on internationally comparable OECD indicators of policy settings and performance. The additional two priorities are often supported by indicator-based evidence, but may draw principally on country-specific expertise. These priorities 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 so as to uncover specific areas of relative strength and weakness. Each performance indicator is juxtaposed with corresponding policy indicators, where OECD empirical research has shown a robust link to performance, to determine where performance and policy weaknesses appear to be linked. This evaluation process is carried out for each of the approximately 50 areas where OECD policy indicators provide coverage.

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). Since many of the approximately 50 indicators are associated with more than one performance area, there are potentially more than 100 potential pairings to be examined. The indicators of policy and performance are standardised by re-scaling them so that each has a mean of zero and a cross-county 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.

Candidates for recommendations thus fall into the lower left quadrant, where policy indicators and corresponding performance are *both* below average. In most countries there are more than three unique policy areas that qualify as potential priorities (for instance, Germany had 16 candidates in the 2009 exercise). When there are more than three candidate policy priorities, the list has been narrowed using a combination of country expertise with the following criteria: *i*) the estimated quantitative impact of reforms in the policy area on GDP per capita as determined in previous OECD analysis, *ii*) the normalised distance of the policy stance from the benchmark (the OECD average), and *iii*) recent trends in policy and performance. The limit on the number of priorities means that for some countries, obvious policy imperatives may not be identified as priorities because other priorities are deemed as more important.

Figure 1.A1.1. **Example of selection of candidates for *Going for Growth* priorities**



StatLink http://dx.doi.org/10.1787/888932372982

The empirical research linking policy with performance includes a long series of studies carried out by the Secretariat as well as the academic literature. OECD studies include for instance the OECD (2003), OECD (1994) and its reappraisal (OECD, 2006). Carrying out empirical analysis to strengthen the underpinnings of *Going for Growth* recommendations is an ongoing process. Some new empirical evidence on the policy and institutional drivers of long-term economic growth for both OECD countries and the BRIICS is featured in Bouis *et. al.* (2011).

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ANNEX 1.A2

Structural Policy Priorities[1]

By country, performance area and impact on the current account (CA) and the fiscal position (FP)[2]

	Labour utilisation		Productivity	
Australia			Enhance capacity and regulation in infrastructure by encouraging the use of cost-benefit analysis for public projects and by stimulating efficient investment decisions through the introduction of congestion charges and efficient market pricing.	
			Relax barriers to FDI and increase transparency of approval decision to boost investment.	
	Improve incentives for workforce participation by reducing marginal effective tax rates, especially for low income families.		Improve the efficiency of the tax system by reducing corporate and personal income tax to further rely on indirect taxes.	
			Enhance access to early education, especially for disadvantaged groups, to improve their educational outcomes.	
Austria	Reduce disincentives to work at older ages by reducing the fiscal subsidisation of early retirement and tightening eligibility criteria for disability pension.	FP/CA	Raise graduation rates from tertiary education by extending the performance-based funding and allowing universities to set tuition fees backed by student income contingent repayment loans (ICRL).	FP/CA
	Strengthen incentives to work and entrepreneurship by reducing marginal taxes on labour income financed by broadening the tax base and more relying on indirect taxes.	CA	Promote competition in network industries by reducing ownership restrictions and other barriers to entry.	FP/CA
			Promote competition in professional services by reducing statutory regulation of trades and professions and abolishing compulsory chamber membership.	
Belgium	Reduce disincentives to work at older ages by phasing out remaining early retirement options.	FP/CA	Promote competition in retail distribution by further easing regulation on zoning and opening hours as well as in network sectors by establishing a single independent regulator.	CA
	Further reduce tax wedges on low-income workers to increase employment opportunities for this group and move to a more efficient tax structure by further relying on indirect taxes.	CA		
	Reform the wage bargaining system by decentralizing wage negotiations and phasing out wage indexation so that wages better reflect local labour market conditions.			
	Reduce unemployment benefits with duration to strengthen work incentives.			
Brazil	*Follow through the reform package of the tax system by notably reducing burden on labour income and unify the tax system.*		Increase the quality of services at primary and secondary levels and expand tertiary vocational and professional training.	
	Improve incentive for formal labour force participation by encouraging human capital accumulation and lowering social contribution for low-paid workers.		Enhance economy efficiency by gradually lowering bank reserve requirement and phasing out distortionary mandated credit provisions to some sectors.	
			Improve infrastructure provision by lowering regulatory uncertainty and removing legal barriers to competition to spur private investment.	

	Labour utilisation		Productivity	
Canada	*Reform the employment insurance system by introducing a firm-level employer experience rating.*		Reduce barriers to competition in network industries, retail and professional services. Continue to implement scheduled corporate tax rates reductions. Reduce high personal income taxes and move the tax base toward indirect taxes. Further reduce barriers to foreign ownership to boost productivity-enhancing capital deepening, especially in telecommunication and air transport sectors. *Improve incentive for innovation by reforming current R&D support programmes and re-focusing toward those with largest return.*	
Chile	Ease employment protection legislation for regular workers and increase unemployment benefits as a counterpart. *Strengthen female labour participation by extending publicly-financed early childhood education.*		Ease product market regulation by reducing administrative burdens for start-ups, reduce barriers for entry in retail sector and simplify the bankruptcy law. Improve secondary and tertiary education outcomes to increase efficiency and the adoption of new technologies. Strengthen competition by implementing a new competition law.	CA CA CA
China			Reduce the importance of the state-owned sector in the economy to boost efficiency. Improve educational outcomes by reducing inequalities in the provision of education regionally and within urban areas. *Conduct a regulatory impact analysis to review all regulation and thereby reducing administrative burdens on companies.* *Further enhance intellectual property rights and the rule of law.* *Reduce barriers to urbanisation, so as to enable reallocation of labour to high-productivity sectors of the economy.*	CA CA CA
Czech Republic	Cut the costs of employment protection legislation (EPL) for regular workers to stimulate hiring. *Increase incentive to work for low income and second earners by reforming the tax-benefit system.*	CA	End the too-early selection process in secondary education and enhance the education outcomes. Implement proposals for tertiary education fees backed by student ICRL. Improve the business environment by further streamlining administrative procedures for start-ups and strengthen competition in electricity and telecommunication sectors. *Improve efficiency in public expenditures by reforming health care and public procurement mechanisms.*	FP FP
Denmark	Reduce the top marginal tax rates on labour income to cut disincentives to work longer hours while restraining public expenditure growth. Reduce subsidies to the disabled employment programme (*Fleksjob*) to encourage return to employment by those with some work capacity. *Reduce housing subsidies and abolish rent regulation to minimise housing market distortion and facilitate labour mobility.*	CA	Improving the efficiency of the education system by enhancing the culture of evaluation and introduce tuition fees backed by students ICRL. *Enhance competition in retail trade and continue with privatisation and outsourcing of publicly-funded services.*	CA CA
Estonia	Improve the capacity of the unemployment fund to provide efficient job assistance.		Reduce barriers to entry in network industries especially in the electricity market. Reduce administrative burdens on businesses especially regarding the purchases of land by non-EU citizens. Further reduce barriers to FDI. Improve private bankruptcy proceedings.	CA CA
European Union	*Raise labour mobility by improving the portability of pension and social welfare benefits to improve intra-EU labour mobility.*		Increase competition in services sector by ensuring effective. Implementation of the Services Directive. Raise competition in network industries by removing intra-EU barriers. Reduce producer support to agriculture by further decoupling payments to production. *Reforms financial regulation by giving sufficiently power to the newly-created European bodies and deepen market integration notably in retails.*	

	Labour utilisation		Productivity	
Finland	Strengthen work incentives by further reducing the tax wedge on labour income and shift the tax structure toward indirect taxes.	CA	Increase productivity in municipalities by relying more on outsourcing, promoting municipal mergers and increasing reliance on benchmarking.	FP
	Phase out early retirement pathways and increase the minimum statutory retirement age to reduce work disincentives at older ages.	FP/CA	*Improve efficiency of the tertiary education system by reducing inefficiencies in access to upper education and introduce tuition fees backed by student ICRL.*	FP/CA
	Strictly enforce job search requirements and reduce unemployment replacement rates to increase work incentives.	FP		
France	Further reduce disincentives to work at older ages to raise employment of those above the age of 55.	FP	*Improve the quality and efficiency of tertiary education through further efforts to extend the autonomy of universities and higher tuition fees backed by student ICRL.*	FP
	Stimulate labour demand for youth and the low-skilled by further allowing the minimum cost of labour to decline relative to the average wage.		*Reduce regulatory barriers to competition in network industries and retail distribution.*	
	Reduce the duality of the labour market by further reducing the protection of permanent jobs.	CA		
Germany	Strengthen work incentives by reducing social security contribution rates financed by efficiency gains in health care system and/or shift in the tax system toward indirect taxes.	CA	Reduce barriers to competition in services sector by simplifying the licence and permit system, the entry condition and easing conduct regulation.	CA
	Reduce disincentives to full-time female labour force participation by moving to individual taxation of couples and introducing health care contribution for non working spouses.	FP	Improve tertiary education outcomes by postponing early tracking, allowing universities to select student and introducing tuition fees backed by student ICRL.	CA
	Ease employment protection legislation on regular jobs to avoid the development of a dual labour market.			
Greece	Continue to increase incentives to work at older ages by proceeding to the full implementation of the pension bill.	FP	Promote competition in network industries by reducing public ownership and proceed to the liberalisation of closed professions.	
	Continue efforts to broaden the tax base and tax evasion. Consider reducing the tax wedge on labour income over time to discourage evasion and informal activities.		*Raise the quality of education through improvements in teaching quality and increase in autonomy of schools.*	FP
	Stimulate labour demand for youth by proceeding with the full implementation of law introducing a sub-minimum wage for young people.			
Hungary	Further reduce social contributions in a revenue-neutral way so as to maintain a sound fiscal position. Finance recent tax cuts through expenditure restraint, base broadening and higher property taxes rather than through one-off distortive taxes on specific sectors and dismantling of the mandatory funded pension pillar.		Ease business regulations by simplifying entry and exit procedures to encourage competition.	
	Encourage the labour force participation of older workers by further reducing implicit tax rates on continued work and phasing out access to early retirement programmes, including by tightening eligibility for disability benefits.	FP	*Improve the efficiency of education system by delaying early tracking, improving teacher training and introducing tuition fees backed by student ICRL.*	FP
			Promote public sector efficiency by ensuring cost-efficiency of services.	FP
Iceland			Improve education outcomes by strengthening school accountability and improving teacher quality.	FP
			Reduce producer support to agriculture.	FP
			Reduce foreign ownership restrictions in the fisheries and electricity sectors to increase competition.	FP
			Introduce *performance-based budgeting in the public sector to raise public-sector efficiency.*	FP
			Reduce legal barriers to entry in electricity, telecommunications and transport sectors.	

	Labour utilisation		Productivity	
India	Improve labour market flexibility in the formal sector and reduce protection measures that discriminate against large firms.	CA	Reduce trade and FDI barriers notably in retail and other service sectors as well as administrative burdens.	
			Improve education outcomes by decentralising school management and recruitment, increasing teacher training and autonomy in universities.	
			Reduce regulatory uncertainty to enhance infrastructure provision from private sector.	
			Develop the financial sector to meet the needs of a rapidly developing economy.	
Indonesia	Simplify dismissal procedures and reduce severance payments while introducing some form of unemployment benefits to address informality.		Improve the efficiency of secondary education by making income transfer conditional on attending school and financing fee for disadvantaged children.	CA
			Improve the environment for infrastructure by reducing regulatory barriers and uncertainties to spur private investment.	CA
			Ease barriers to entrepreneurships and continue to fight corruption by reforming the tax office and simplifying business licensing.	CA
			Phase out energy subsidies.	
Ireland	Strengthen work incentives for women by further targeting and, as fiscal circumstances allow, increasing the supply of childcare.		Strengthen competition in retail, electricity and gas markets. Remove unnecessary restrictions in the legal profession.	
	Enhance activation policies by tightening conditionality and reducing the number of agencies involved in providing assistance to the unemployed.		Enhance R&D spending and innovation by ensuring that government support channels through efficient tools and promoting the links between universities and the private sector.	
			Further improve the quality and quantity of infrastructure provision. Allow for better use of infrastructure services through appropriate user charges.	FP
Israel	Reduce tax wedge and corporate tax. Shift tax structure toward indirect taxes.	CA	Improve education outcomes by reforming upper-secondary school.	CA
	Encourage labour supply among low-income households by re-introducing a placement scheme, increasing the coverage of earned-income-tax credit, reducing the value of minimum wage relative to average.		Cut red tape for businesses to boost firm entry and productivity.	CA
			Complete network industry reform notably in electricity and telecoms sectors.	CA
Italy	*Relax job protection on permanent contracts to increase labour demand for permanent workers and reduce labour market dualism.*	CA	Reduce regulatory and administrative barriers to competition notably in professional services.	
			Improve efficiency of secondary and tertiary education by promoting evaluation, improving the quality of teachers and setting tuition fees backed by student ICRL.	FP
			Reduce the tax wedge on labour income and the corporate tax rate and shift the tax structure toward indirect taxes.	
			Reduce public ownerships in some sectors. Enhance competition especially in media TV.	FP
Japan	Reduce the duality of the labour market by cutting the costs of EPL for regular workers while expanding insurance coverage for non-regular.		Increase competition in network industries, particularly electricity, notably by further deregulation and privatisation.	FP/CA
			Further scale back the level of support to agriculture, while shifting its composition away from support based on output and towards direct support for farmers.	FP/CA
			Remove restrictions on FDI especially in services.	CA
			Reform the tax system to rely more on indirect taxes to reduce the efficiency cost of taxation.	CA

	Labour utilisation		Productivity	
Korea	Reduce employment protection for regular workers to reduce the incentives to hire non-regular workers and improve training opportunities.		Further reduce entry barriers in network industries and services and relax FDI restrictions to stimulate productivity.	CA
	Strengthen female labour force participation by expanding the availability and the quality of child care by relaxing price control.		Reduce producer support to agriculture.	CA
			Improve the efficiency of the tax system by broadening tax bases and shifting toward indirect taxes.	CA
Luxembourg	Improve work incentives by reducing replacement rates of social benefits, tightening unemployment insurance eligibility and activating labour market policies.		Increase competition by liberalizing professional services and retail sectors opening hours.	CA
	Reduce disincentives to work at older ages by phasing out early retirement schemes.	CA		
	Reform employment protection by easing conditions on collective dismissals and reducing restrictions on temporary contracts.			
	Improve the functioning of the housing market by reforming the planning system and reducing implicit tax subsidies to home ownership.			
Mexico			Raise achievement in primary and secondary education to raise productivity and the adoption of new technologies.	
			Promote competition in network industries by reducing regulatory barriers to entry.	
			Reduce barriers to foreign ownership especially in electricity and telephony sectors.	
			Improve the "rule of law" to strengthen competition and investment.	
			Improve the governance of the state-owned oil company and facilitate risk and profit sharing with other companies to enhance efficiency.	
Netherlands	Lower marginal effective tax rates to strengthen incentives to full-time labour force participation for low income and second earners.			
	Ease employment protection legislation for workers on regular contracts by making the current dual system of dismissal more predictable.			
	Extend the new tighter entry controls and better monitoring to all existing disability benefit recipients to encourage work by those with substantial work capacity.	FP		
	Temper unemployment benefit duration to enhance incentives to work.	FP		
	Make the housing market more flexible and cut transaction tax to strengthen labour mobility.	FP		
New Zealand			Reduce barriers to competition in network industries.	FP
			Ease entry barriers for foreign acquisition of large firms and reduce regulatory opacity.	
			Improve educational achievement, in particular among ethnic minorities, to raise efficiency of the labour force.	FP
			Boost direct public R&D funding, raise the effectiveness of R&D support by fostering policy co-ordination.	
			Improve public-sector efficiency by implementing the welfare reform.	FP
Norway	Reform disability benefit schemes to encourage work by partially disabled through reinforcement of conditionality.		Reduce legal barriers to entry in some services, notably telecommunications, retail and post.	CA
	Reduce marginal income tax rates to strengthen incentives to full-time labour force participation and shift tax system toward indirect taxes and property taxes.	CA	Reduce producer support to agriculture.	CA
			Raise the efficiency of secondary education by reducing the number of schools, improving teacher training and relying on performance indicators.	CA

	Labour utilisation		Productivity	
Poland	Reform the tax and benefit systems by further reducing the tax wedge and tightening eligibility for early retirement.		Reduce public ownerships by further privatisation.	FP
			Improve the provision of pre-school education and introduce fees in tertiary education backed by students ICRL.	FP
			Increase transport, communication and energy infrastructure.	
			Increase housing supply by reforming zoning arrangements.	
Portugal	Ease employment protection legislation on regular contracts and refocus unemployment benefit systems.	CA	Improve secondary and tertiary attainment to raise efficiency of the labour force.	FP
			Foster competition in retail and railways, make licensing less restrictive in professional services and downscale public ownership in transportation.	FP
			Reduce administrative burdens on business at the local level.	
			Simplify the tax system and broaden the tax base notably by reducing tax expenditures for all taxes.	
Russia			Lower barriers to trade and foreign direct investment by reducing tariffs level and dispersion and by shortening the list of strategic sectors.	CA
			Reduce state control over economic activity by reducing the list of strategic firms and by favouring regulatory measures to direct interventions.	CA
			Raise the effectiveness of innovation policy by pursuing reforms in the state science sector and by relying more public support on fiscal incentives.	
			Raise the quality of public administration by simplifying regulation, reducing bureaucratic interference in private sector and corruption.	
			Increase public funding and efficiency of health care system by improving incentives for providers and developing prevention policies.	CA
Slovak Republic	Raise female labour force participation by shortening the duration of parental leave entitlements in favour of childcare subsidies.		Improve the effectiveness of the education system and the funding through the introduction of tuition fees backed by student ICRL.	FP
	Reduce long-term unemployment by strengthening policies to promote labour mobility notably through the expansion of training measures.		Foster competition by reducing administrative burdens on firms and resuming privatisation process in telecommunication and energy sectors.	FP
			Improve the innovation framework by reducing administrative burden on start-ups and facilitating access to venture capital.	
Slovenia	Relax employment protection legislation by further easing individual dismissals.	CA	Reform product market regulation by reducing state ownership in network industry and corporate governance of firms in which the State holds stake.	
	Reduce the disincentives to work at older ages by rising the statutory retirement age.		*Improve tertiary educational outcomes by linking student benefits to performances and introducing tuition fees backed by student ICRL.*	
	Abolish the indexation of public sector wages and ensure the minimum wage is indexed to inflation for a while.			
South Africa	*Strengthen policies to tackle youth unemployment by implementing an age-differentiation of minimum wages, wage subsidies and intensifying placement assistance.*		Raise the quality of education and reduce its dispersion by improving teacher training, schools infrastructures and phasing out schools fees.	
	Weaken administrative extension of collective bargains and provide for indicative guidelines for wage bargains at centralized level.		Enhance competition in network industries by removing entry barriers and phasing out granting state-owned enterprises.	
			Reduce barriers to entrepreneurships and reduce administrative burdens based on a review of existing legislation.	

	Labour utilisation		Productivity	
Spain	Make wage more responsive to economic and firm-specific conditions by abolishing legal extension of collective wage agreements.		Improve secondary education by evaluating vocational schools and raising school autonomy.	FP
	Ease employment protection legislation for permanent workers by considering introducing a single contract.	CA	*Strengthen competition in retail distribution by lowering regional barriers to large-surface outlets.*	
	Further lengthen the contribution periods required for a full pension and abolish subsidies to partial retirement to increase incentives for older workers to continue working.	FP		
Sweden	Pursue reforms of sickness leave and disability benefit systems to increase labour force participation.		*Improve the efficiency and quality of education by strengthening compulsory schooling and introducing tuition fees in universities.*	CA
	Relax EPL for regular contracts by easing procedures for dismissals.			
	Reduce marginal tax rates on labour income to strengthen incentives to work longer hours by further raising income tax threshold and shift tax burden toward property and consumption taxes.	CA		
	Reform housing policies to encourage labour mobility.			
Switzerland	Strengthen incentives to full-time work for women by a nation-wide voucher scheme to subsidies childcare and an individual taxation of couples.		Remove barriers to competition in network industries by strengthening the regulator's powers, removing legal barriers to access the telecommunication sector and privatising the postal services provider.	CA
			Reduce producer support to agriculture.	CA
			Improve tertiary education by delaying tracking and raising tuition fees backed by student ICRL.	CA
			Contain health-system costs by abandoning the mixed hospital funding.	
Turkey	Contain minimum wage increases to stimulate employment of low-skilled workers in the formal sector.		Improve educational achievement and increase public education spending financed by broadening tax base.	
	Ease employment protection, liberalise temporary work and allow flexible forms of labour contracts to stimulate hiring in the formal sector.	CA	*Simplify product market regulations, pursue especially the simplification of licensing rules and advance privatisations.*	
	Reduce disincentives to work in the formal labour market by making the pension system actuarially neutral.			
United Kingdom	Further reform the disability benefit scheme by extending it to all existing claimants.	FP/CA	Improve the education achievement of young people by increasing quality of early-childhood education and increase secondary school participation.	FP
			Improve public infrastructure, especially for transport, to reduce bottlenecks.	
			Improve the efficiency of health and other publicly-funded services.	FP
			Make the planning system more flexible to encourage supply of land for housing and commercial development.	
United States			Improve primary and secondary education by improving teacher training and strengthening schools' accountability for student progress.	FP
			Improve the efficiency of the health care sector by pursuing efforts to reform Medicare.	
			Improve the efficiency of the tax system by shifting toward consumption taxes.	FP
			Strengthen policies to promote social mobility by increasing participation in early childhood education, reducing financial barriers to participation in tertiary education.	
			Reduce producer support to agriculture notably tariffs on imported ethanol, sugar and dairy price support.	FP

1. The priorities in italics are not necessarily based on indicators.
2. CA denotes priorities that could contribute to reduce the current account surplus or deficit. FP denotes priorities that could contribute to strengthen the fiscal position in countries identified in the main text as having moderate to very large fiscal consolidation needs.

ANNEX 1.A3

Incorporating Household Production Into International Comparisons of Material Well-Being

Traditional national income accounting has generally followed the principle that households are final consumers – rather than producers – of goods and services. Consequentially, goods and services produced by households for the market are included in economic aggregates such as GDP, as are goods produced for own-consumption, such as agricultural products and own-account construction, but non-market services produced by households, with the notable exception of dwelling services, are not. This has the problematic implication that when services are sourced from the market rather than produced at home, national income rises, even if the volume and/or quality of actual production and consumption does not increase. For international comparisons purposes, this could be especially problematic for comparisons of countries at earlier stages of development, where markets for certain types of food, cleaning and childcare services are less developed.

Satellite accounts have been constructed in a number of OECD countries to help to address this problem (including for Australia, Canada, Finland, Germany, Hungary, Mexico and the United Kingdom). A recent study of the United States, for example, showed that extending the production boundary to include household production of non-market services not already included in GDP would increase US GDP by 19% using the replacement cost approach (with production valued at housekeepers' hourly wages), and 62% using the opportunity cost (using average hourly wages) approach.[1] Interestingly however, average annual real growth over the period 1985-2004 differed by only 0.1% percentage point between the two approaches, indicating that non-market services (as a share of total output) do not vary significantly over time. In terms of income gaps, the Commission on the Measurement of Economic Performance and Social Progress set up by French President Sarkozy found that broadening measures of material well-being to incorporate household production would reduce the income gap between France and the United States by about 5 percentage points (Stiglitz-Sen-Fitoussi, 2009).

This annex explores measures that extend GDP measurement to non-market production using recently available time-use surveys, and thereby may come closer to true measures of material well-being. Overall, these measures present a picture of national income that is quite different from the traditional one, on average 45% higher than standard measures of GDP per capita. However, they are also surrounded by a considerable degree of uncertainty, with different choices of methodology leading to 25% or 66% higher average GDP per capita, depending on whether the replacement cost or opportunity cost method is used. Nevertheless, the ranking of countries in terms of income is not substantially affected by the incorporation of household production, whichever price basis is used, although the income gap between the five lower income OECD countries in the sample and the sample average is reduced substantially (by about 20 percentage points). Yet the ranking can change more substantially for labour productivity levels once non-market production and the associated inputs (in terms of hours worked) are accounted for, with several countries changing their position in the distribution rather dramatically.

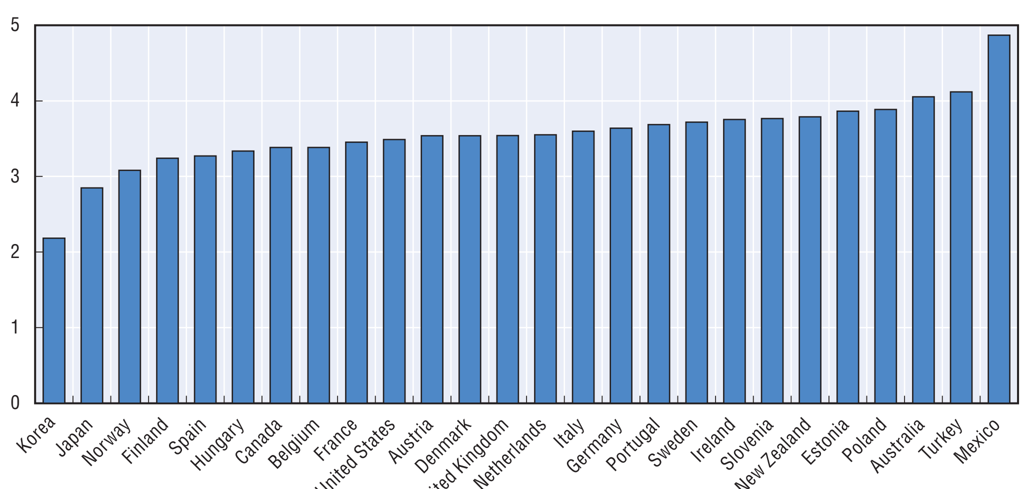
Making use of time-use surveys

The starting point for this work is a new database of time-use surveys collected by the OECD (Miranda, 2011). This database collates time-use surveys conducted by national statistics institutes for 2008 using a classification of activities based on five primary categories defined by the OECD: paid work or study (work-related activities); unpaid work (household activities); personal care; leisure;[2] other activities not included elsewhere.

For the purposes of measuring household production of non-market services, the relevant activity is unpaid work, which is broken down into the following two-digit groups: routine housework; shopping; care for household members; care for non household members; volunteer work; and travel related to household activities. Unfortunately not all countries are able to provide a breakdown into all six categories and, so, this analysis looks only at total time spent on overall unpaid work. Some of this time will be spent on activities related to the production of goods such as agricultural products for own-use, or the production of goods such as community housing, through voluntary work, that are not for own-use. The output related to the production of these goods is, at least in theory, already included within estimates of GDP. Therefore, estimates of household production of non-market services that include these activities will be biased upwards, though the size of such bias is expected to be small.

The figure below (Figure 1.A3.1) summarises the information available from time-use surveys for 26 OECD countries. It shows that in most OECD countries the average time per

Figure 1.A3.1. **Average hours spent on unpaid household work per person, 2008**[1]



1. Includes people aged 15 and older. Austria and Denmark are set at the European Union average.

Source: OECD estimates based on national time use surveys.

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person spent on unpaid household work falls between three and four hours per day, with the notable exceptions of Korea, where the average is just over two hours per day, and Mexico, where the average is close to five hours per day.

When households produce own-account services, they use labour input (household members' time) and capital (consumer durables). Two approaches are used to estimate the value of the labour supplied in producing these services (see Box 1.A3.1 which also provides details on the approach used to estimate the value of capital services). The first is the *replacement cost* approach; where an average post-tax, hourly wage, representative of the broad range of activities covered in the production of household production of non-market services, is constructed using data collected in the OECD-Eurostat PPP programme. The second, to provide some measure of the potential range of estimates (in practice an upper bound), is the *opportunity cost*[3] approach, which takes the average post-tax hourly wage across the whole economy (see OECD, 2010).

The effect on income levels is very large but cross-country rankings are little affected

Applying the methods discussed above to estimate household production yields estimates of material well-being that are significantly higher in level terms than standard GDP per capita measures. Figure 1.A3.2 shows the results of the two methods of estimating household production of non-market services. These estimates apply both the labour cost and the capital services estimates described in Box 1.A3.1. Using the replacement cost method, the augmentation of GDP per capita ranges from 10% for Norway to 50% for Mexico, averaging 25% across the OECD sample. With the opportunity cost method, the augmentation is even larger: 32% in the case of Norway and 121% for Mexico, and 66% on average.

While the effect on the level of income is drastic, the effect on the relative position of countries is much less substantial.[4] The rankings stay qualitatively similar, though some countries certainly improve in their position – for instance, Germany and Portugal each jump forward in the distribution (Figure 1.A3.3). More substantively, the distribution is compressed, with the five lowest income countries' GDP per capita augmented by well more than average: with the replacement cost method, these countries' income rises by 38% compared with 25% on average; with the opportunity cost method, they increase by 93% *versus* 66%. Although the large margin of uncertainty that surrounds these estimates using the two methods suggests caution in using these augmented figures in practice, volume-based (real) international *comparisons* of incomes are much less affected by the choice of methods – as evident in the fairly stable ranking of countries across both methods.

In principle, cross-country comparisons of productivity levels could be more affected than comparisons of GDP per capita levels, at least through a composition effect – *i.e.* because the relative number of hours devoted to household production varies across countries, and the relative productivity of household production *vis-à-vis* other economic activities also varies across countries – and further OECD work will be carried out on this issue. However, whether any changes in cross-country rankings of productivity levels would have implications for *Going for Growth* reform priorities is less clear. For instance, insofar as most policies and institutions have only little direct impact on the productivity of non-market household services, the latter may be ignored when mapping productivity measures with structural policy indicators to identify priorities.

Box 1.A3.1. **The opportunity cost *versus* replacement cost approaches**

Conceptual arguments can be made that favour both the opportunity and replacement cost approach, although the latter seems generally more in line with national accounts concepts. In practice, most studies that have produced estimates of household production have based these estimates on replacement costs, following the underlying valuation principle that the ultimate goal is to obtain the equivalent market value of the non-market services produced. In other words, it is the price that would be paid for somebody else to produce the same quality of service. Another advantage of the replacement cost approach over the opportunity cost approach is that the latter necessarily assumes that any person considered, including those outside the labour force such as full-time housewives or retirees would be able to find a job in the market according to his or her qualifications, which is a very strong assumption. One could even go as far as setting the opportunity cost equal to zero (see Abraham and Mackie, 2007) in the extreme case where the individual's competences have no value on the labour market. However, estimates based on the opportunity cost approach are not meaningless. At the very least they provide in practice an upper bound on estimates of household production. Therefore they are also shown in this analysis.

A complication arising in the replacement cost approach is that the underlying general principle for the valuation of hourly labour costs should in theory be the quality-adjusted price of a specialist worker in the activity being measured, where the quality is adjusted to reflect the lower productivity of non-specialised individuals. In practice and in this annex however, many studies do not adjust for quality, and those that do generally rely on fairly arbitrary estimates of the productivity gap between specialists and non-specialists. Landefeld *et. al.* (2009), for example, assumed that the average hourly wage was 75% of the specialist hourly wage in a number of activities. Because this study focuses on total time spent on unpaid work, and because price information is not readily available for the six specific two-digit categories of unpaid work in time-use surveys, estimates cannot be based on the costs of specialised labour in specific activities. Instead, this study relies on an overall hourly labour cost estimate based on prices of market activities that are representative of the main activities conducted by households in the production of non-market services, such as the wages of unregistered domestic servants.

The estimates of hourly wages for both the replacement and opportunity cost approach are based on the assumption that the market price would reflect the prices paid for informal, unregistered labour, and so are net-of taxes and social security contributions. Not all studies have estimated labour costs on this basis, And some have for example used gross measures. For the replacement cost approach, when direct estimates of the hourly wages of unregistered workers are not available, estimates of hourly post-tax wage costs are based on hourly wage costs of registered workers adjusted for taxes and social security contributions using data from *OECD Taxing Wages 2009*, where the tax "wedge" is computed as the average tax and social security contributions paid by employees (as a per cent of total wages) across two situations, namely for a single person with no children earning two-thirds of the national average annual salary and for a single person with two children earning two-thirds of the national average annual salary. Similarly, for the opportunity cost approach the average tax wedge is calculated as the average for a single person earning 100% of the national annual average salary and a sole earner married with two children earning 100% of the national annual average salary. It is important to note in this context that estimates of "net" prices based on registered workers may be biased downwards in comparison to unregistered workers since the after-tax cost of labour charged by unregistered workers may be higher in order to reflect at least some of the social benefits captured by registered workers. Similarly the choice illustrative family situations considered in the calculation of the tax wedge for the replacement cost approach reflect the fact that unregistered workers are typically at the lower end of the salary scale.

Box 1.A3.1. **The opportunity cost *versus* replacement cost approaches** *(cont.)*

The overall approach to measure the (replacement or opportunity) costs of labour used in the production of household non-market services for own use can be simply described as follows:

Value of labour used in household production of non-market services in nominal currency

=

Average hourly post-tax labour costs

*

Average hours worked per day

*

Days in a year

*

Population, 16 years-of-age and over

For the purpose of cross-country comparisons, the preference and focus of this annex is to present results in volume terms – in other words by converting the nominal values into 2008 US dollars using purchasing power parities, and comparing country estimates on the basis of both the replacement and opportunity costs.

Beyond labour inputs, capital services are another basic input in the production of household non-market services, and may also substitute for labour. Clearly innovations and inventions such as the dishwasher, washing machine, and microwave have provided possibilities for substituting capital for labour. Including the contribution of consumer durables is important therefore to fully reflect the consumption of goods and services by households in a consistent way across countries and over time. Consumer durables used in this analysis are based on the Eurostat-OECD (2007) classification of final expenditure by GDP category, which includes household appliances, motor vehicles and also categories of consumer durables, such as furniture, that provide capital services related to dwelling services – but dwelling services themselves are not included in this study. It is important to note that these estimates will be biased upwards since some consumer durables, such as cars, also provide capital services to commuting and leisure activities.

The results shown in this annex are based on measures of the productive stock of consumer durables constructed using the perpetual inventory method, based on the standard stock-flow relationship:

$$K^t = K^{t-}(1-\delta) + I^t$$

Where, K^t is the end-of-the-period net stock of consumer durables, I^t is the flow of purchases of consumer durables during period t in constant (chained) prices, δ is the geometric rate of depreciation, set at 20%. Note that no distinction is made between different types of consumer durables in this analysis.

The value of capital services is measured as the price of capital services per unit of the net stock multiplied by the net stock (see Jorgenson and Griliches, 1967). The capital service price contains three elements: return on capital, depreciation, and revaluation of capital goods. A simplified version of the capital service price for consumer durables is estimated as:

$$P_K{}^t = P_I{}^t\,[r+\delta]$$

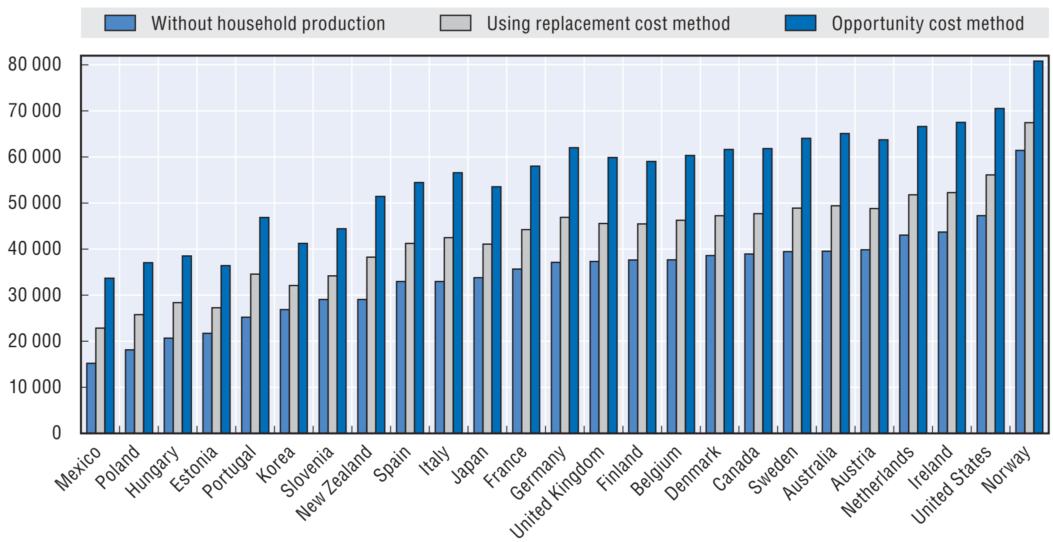
Where *r* is the real rate of return, set at 4% per year, $P_K{}^t$ is the price of capital services and $P_I{}^t$ is the price index of consumer durables. The value of capital services from consumer durables is therefore:

$$P_K{}^t\,K^t = [r+\delta]P_I{}^t\,K^t$$

Source: Abraham, K. and C. Mackie, eds. (2005), *Beyond the Market: Designing Non-market Accounts for the United States*, The National Academy of Sciences; Landefeld, S., B. Fraumeni and C.M. Vojtech (2009), “Accounting for Nonmarket Production: A Prototipe Satellite Account Using the American Time Use Survey”, *Review of Income and Wealth*, Vol. 55, No. 2; OECD (2010), *Taxing Wages 2009;* OECD/Statistical Office of the European Communities, Luxembourg (2007), *Eurostat-OECD Methodological Manual on Purchasing Power Parities;* Jorgenson, D.W. and Z. Griliches (1967), “The Explanation of Productivity Change”, *Review of Economic Studies*, Vol. 34, No. 3.

Figure 1.A3.2. **GDP per capita with and without household production, 2008**

Current USD PPP



Source: Ahmad, N. and S-H Koh (2011), "Incorporating Household Production into International Comparisons of Material Well-Being", *OECD Statistics Directorate Working Papers*, forthcoming.

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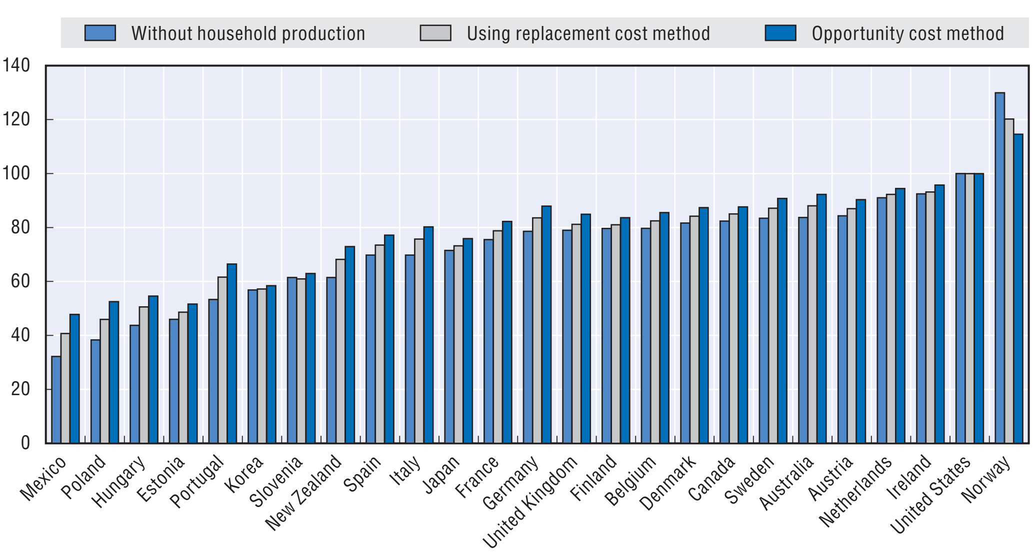
Figure 1.A3.3. **GDP per capita with and without household production, 2008**

USA = 100



Source: Ahmad, N. and S-H Koh (2011), "Incorporating Household Production into International Comparisons of Material Well-Being", *OECD Statistics Directorate Working Papers*, forthcoming.

StatLink http://dx.doi.org/10.1787/888932373039

Notes

1. See Landefeld, *et al.* (2009).
2. This annex focuses on time spent on household production. From a time-use perspective, value could also be given to other ways in which time is spent, in particular leisure. Placing a value on time spent on leisure, such that it can be compared with the benefits gained from conventional consumption of market goods and services or the consumption of goods and services produced by households for their own use, is considerably more challenging, both empirically and conceptually, and thus is not examined in this annex.
3. A full opportunity cost approach would calculate the opportunity costs for each individual separately rather than for an average individual.
4. It should be stressed that any potential cross-country differences in the productivity of households in producing household goods are not taken into account in these calculations, however.

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Economic Policy Reforms 2011
Going for Growth

PART I

Chapter 2

Country Notes

Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

AUSTRALIA

Australia has weathered well the global financial crisis, with its per capita GDP rising to the average of the upper half of OECD countries. However, productivity has lagged. Efforts have been made recently to improve educational outcomes, with reforms in the upper secondary and vocational sectors. Still, weaknesses remain and further actions are needed in the following areas.

Priorities supported by the indicators

Enhance capacity and regulation in infrastructure

There is a shortfall of infrastructure, harming investment, and a lack of policies to ensure its efficient use.

Actions taken: Measures have been adopted to better co-ordinate infrastructure development at the national level. The federal government has raised funding for public investment and further harmonised regulations across states.

Recommendations: Select public infrastructure projects through rigorous and published cost-benefit analyses. Introduce congestion charges to promote better use of roads in agglomerations. Efficient pricing for the use of water and transport infrastructure services is needed to enhance market signals for investment decisions.

Relax barriers to foreign direct investment

Although they might not be binding *a posteriori*, screening procedures still create uncertainties that may limit foreign direct investment.

Actions taken: In 2010, the government raised to AUD 231 million the threshold above which FDI needs to be screened before implementation.

Recommendations: The higher threshold used for US investors (about 1 billion AUD) should also apply to other investors, and the benefit of investment liberalisation provided for by Australia in recent FTAs should be extended to other countries. Transparency would be enhanced by more information on the criteria applied in government decisions and by involving specialist agencies (*e.g.* national securities) in the review process of FDI approval.

Improve the efficiency of the tax system

Corporate and personal income taxes are high by international standards and the tax system is complex, which hampers productivity.

Actions taken: The government has announced a reform to increase and improve taxation on non-renewable resources, lower taxes on all companies (especially the SMEs) and boost the retirement savings of low-paid workers.

Recommendations: Lowering further corporate and personal income taxes and raise the goods and services tax. Simplify and rationalise the states' tax system, especially on housing.

Other key priorities

Increase incentives for workforce participation

Further enhance labour utilisation to deal with supply bottlenecks and the resource boom.

Actions taken: A new employment service system was introduced in 2009. The government also announced measures to improve the work capacity assessment of people on disability benefits.

Recommendations: To boost labour market participation, the authorities should further reduce effective marginal tax rates for low-income families, for instance by increasing the tax-free threshold of the personal income tax.

Improve the performance of early childhood education

Enhance access to early childhood education and care (ECEC), especially for disadvantaged groups, to improve their educational outcomes.

Actions taken: The authorities committed to provide universal access to ECEC for 15 hours per week for four year-olds, improve delivery through the National Quality Agenda and provide additional funding for indigenous children.

Recommendations: Differentiate childcare benefits for children under school age to reflect higher cost structures for very young children and make these benefits more conditional on employment and job search of parents. In the longer term and as fiscal circumstances allow, consider further enhancing the quality of, and access to ECEC to three year-olds, focusing initially on disadvantaged groups.

AUSTRALIA

Structural indicators

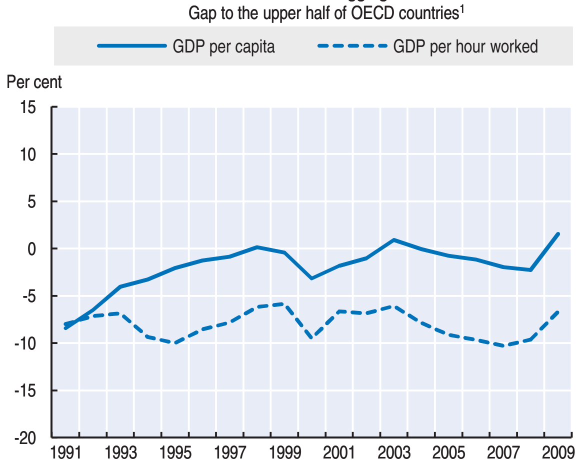
Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		1.9	2.1	1.7
Labour utilisation		0.4	0.4	0.5
of which:	Employment rate	0.7	0.8	0.6
	Average hours	–0.2	–0.3	–0.1
Labour productivity		1.4	1.7	1.2
of which:	Capital intensity	1.1	0.9	1.4
	Multifactor productivity	0.3	0.8	–0.2

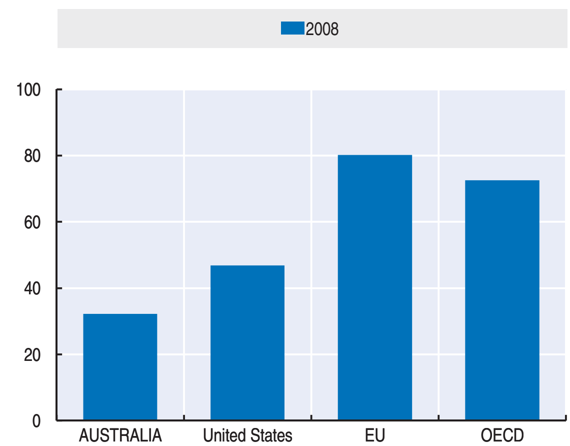
Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

A. The gap in GDP per capita has been closed but productivity has been lagging

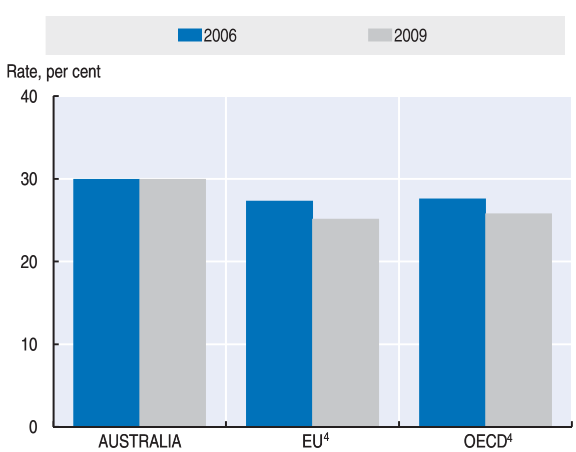
Gap to the upper half of OECD countries[1]



B. Enrolment rates in early childhood education and care are very low[2]

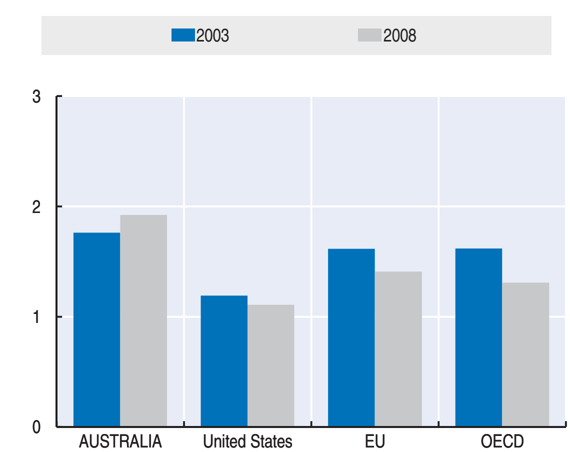


C. The corporate income tax rate is still relatively high[3]



D. Barriers to foreign direct investment are high[5]

Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Enrolment rates of children aged 4 and under as a percentage of the population aged 3 to 4.
3. Combined central and sub-central (statutory) corporate income tax rate.
4. Average of European countries in the OECD. EU and OECD averages exclude Estonia in 2006 and 2009, Israel and Slovenia in 2006.
5. The FDI regulation index looks only at statutory restrictions and does not assess the manner in which they are implemented.

Source: Chart A: OECD, *National Accounts* and OECD *Economic Outlook* No. 88 *Databases*; Chart B: OECD (2010), *Education at a Glance;* Chart C: OECD, *Tax Database;* Chart D: OECD, *Product Market Regulation Database.*

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AUSTRIA

Austria's GDP per capita is below the average of the upper half of OECD countries but its relative position has slightly improved since the mid-2000s, reflecting rising labour productivity before the 2009 recession. In 2009, progress has been made to strengthen early education (kindergarten) and alleviate premature streaming of pupils in secondary schools. However, weaknesses remain and there is need for reform in the following areas.

Priorities supported by indicators

Improve graduation rates from tertiary education

Early tracking of students at age 10 undermines the performance of the school system and particularly penalises immigrant students. The share of young people graduating from academic tertiary education programmes is low, holding back productivity growth and innovation.

Actions taken: The University Act was amended in 2009, involving changes in the appointment of members of university councils, introduction of probationary phases for students and possibility of setting access criteria for graduate school studies. This followed the implementation of a three-year performance budgeting system in 2007. However, the abolition of already low tuition fees for most universities in 2008 was a backtracking in reforms.

Recommendations: Postpone early tracking and strengthen language support to immigrant students throughout their schooling. Extend performance-based funding in tertiary education and allow universities to set tuition fees. Introduce an income-contingent loan system to avoid excluding financially-constrained students.

Reduce incentives to exit early from the labour force

Even after the latest pension reforms, high implicit taxes on continued work at older ages still encourage early retirement and reduce labour force participation.

Actions taken: No action taken since 2009. The 2003-04 pension reforms considerably reduced early retirement incentives. However, some backtracking resulted from the subsequent halving of the discount rate for early retirement in 2007 and the extension of the special early retirement scheme in 2008.

Recommendations: Phase in all provisions of the 2003-04 pension reforms without relaxing their conditions. Tighten eligibility criteria to ensure that disability pensions are only used in well-justified cases.

Reduce barriers to entry in network industries

Despite recent progress in telecommunications, high network access prices and remaining state ownership in some network industries deter new entry, impeding competition and depressing productivity.

Actions taken: Market supervision in the gas and electricity sectors was somewhat strengthened before 2009. New access obligations were set for telecommunication network operators identified as possessing significant market power in the market studies completed in 2010.

Recommendations: Ensure that access prices are not kept artificially high. Relax ownership restrictions that create high barriers to entry at various stages in the production and distribution of electricity. Fully privatise the telecommunication and electricity enterprises. Stimulate competition in rail transportation. Reduce or eliminate remaining cross-subsidies in all network industries.

Other key priorities

Lower marginal tax rates on labour income

High marginal personal income tax rates undermine work and entrepreneurship incentives.

Actions taken: Personal income taxes were lowered somewhat in 2009, including through tax relief for families with children, entrepreneurs and freelancers. Unemployment insurance contribution rates were reduced for low-wage workers in 2008.

Recommendations: Lower marginal income tax rates financed by further broadening the tax base through reducing the numerous tax allowances and possibly increasing taxes on property and consumption (including environmental taxes).

Reduce barriers to competition in professional services

Restrictive regulations remain widespread in services, especially in sectors using self-imposed regulations, hindering competition and productivity growth.

Actions taken: No action taken since 2009. The Crafts, Trade, Service and Industry Act was amended in 2008 to facilitate entry in several professions. Several EU directives concerning professional qualification certificates were transposed before 2009.

Recommendations: Reduce the statutory regulations of trades and professions and curb sectoral self-regulations hindering competition in services. Abolish compulsory chamber membership for liberal professions.

AUSTRIA

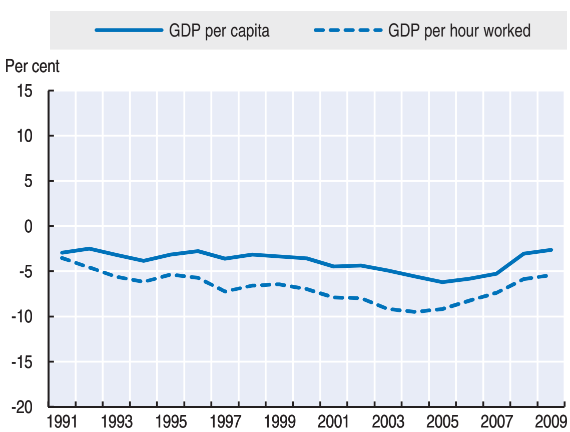
Structural indicators

Average annual trend growth rates, per cent

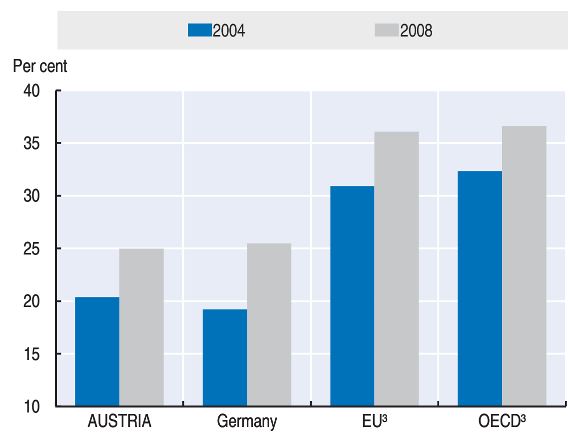
		1999-2009	1999-2004	2004-09
GDP per capita		1.7	2.0	1.3
Labour utilisation		0.3	0.3	0.2
of which:	Employment rate	0.4	0.4	0.4
	Average hours	–0.2	–0.1	–0.2
Labour productivity		1.4	1.7	1.1
of which:	Capital intensity	0.6	0.7	0.5
	Multifactor productivity	0.8	1.0	0.7

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

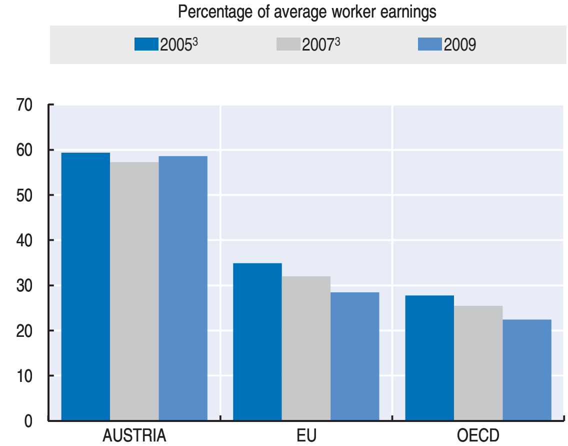
A. The small gap in GDP per capita and productivity persists
Gap to the upper half of OECD countries[1]



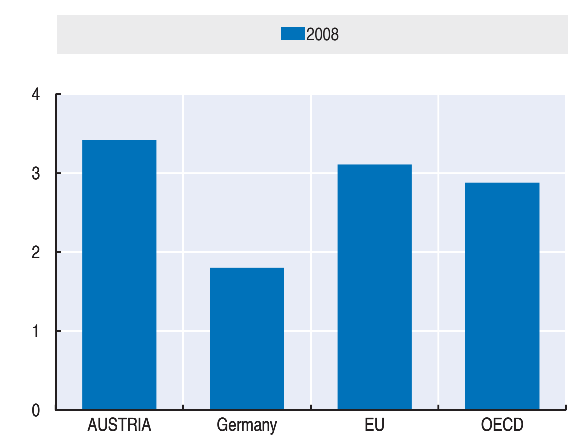
B. Tertiary education graduation rates remain comparatively low[2]



C. Implicit taxes on continued work are still higher than in most other OECD countries[4]
Percentage of average worker earnings



D. State ownership in the netwook sectors is high
Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. First-time graduation rates for single year of age at tertiary-type A level.
3. Average of European countries in the OECD. EU and OECD averages exclude Belgium, Chile, Estonia, France and Korea.
4. Implicit tax on continued work in early retirement route, for 55 and 60-year-olds.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD (2010), *Education at a Glance*; Chart C: Duval, R. (2003), "The Retirement Effects of Old-Age Pension and Early Retirement Schemes in OECD Countries", OECD *Economics Department Working Papers*, No. 370 and OECD calculations; Chart D: OECD, *Product Market Regulation Database*.

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BELGIUM

The GDP-per-capita gap vis-à-vis *best performing countries has narrowed slightly in recent years, but continues to reflect a low level of labour utilisation. There has been some progress in raising the low employment rates of older workers, though little has been done in terms of addressing geographical labour market mismatches. Weaknesses remain and reforms are needed in the following areas.*

Priorities supported by indicators

Phase-out remaining early retirement schemes

Employment rates for older workers are low due to the widespread use of early retirement schemes and other possibilities for early exit from the labour market.

Actions taken: In 2009, the legal retirement age for women was equalised with that for men at 65. Some previously agreed restrictions on early retirement were implemented.

Recommendations: Early retirement schemes should be phased out more rapidly and other exit routes from the labour market should be closed. This includes extending the surtax on negotiated top-ups on unemployment benefits to all wage agreements and phasing out occupational exemptions from the minimum retirement age.

Further ease regulation in the retail sector and the network industries

The retail sector is subject to unusually extensive sectoral regulation, including rules on large outlets, shop opening hours and restrictions on sales, hampering efficiency. Network sectors, particularly energy, are also subject to extensive (multilayer) regulation and unusually broad universal service obligation requirements.

Actions taken: The Trade Practices Act of April 2010 lifted or liberalised a number of Belgian-specific restrictions on sales in the retail sector.

Recommendations: Competition-inhibiting regulation should be scrapped, zoning laws for large outlets should be restricted to evaluating spatial effects and shop opening hours liberalised. In network industries, the complicated regulatory structures should be streamlined, preferably by establishing single independent (nationwide) regulators. Universal service obligation requirements should become less onerous, subject to competitive tendering and financed by the government if retained.

Further reduce the labour tax burden and enhance work incentives in the tax system

The tax wedge is among the highest in OECD countries. Low-income households are faced with high marginal effective tax rates that hamper their labour market participation and increase structural wage pressures.

Actions taken: The government lowered employers' social security contributions and introduced wage subsidies to promote employment prospects for low-skilled, younger, older, R&D and shift-and-night workers as well as for long-term unemployed. In 2010, social security contribution cuts were refocused towards low wage workers.

Recommendations: Wage subsidies and reductions of social security contributions should only be targeted to low-wage earners. Other reductions of social security contributions should be phased out. Remaining labour market traps should be addressed by removing spikes in the effective marginal tax rates. A growth enhancing tax reform should lower rates while broadening bases and move the tax burden away from labour and capital to consumption and immovable property.

Other key priorities

Make wage setting more flexible

The centralised wage bargaining system prevents adjustments to local labour market conditions while wage indexation hampers flexible wage adjustment.

Actions taken: No action taken.

Recommendations: Wage negotiations should become more decentralised and wage indexation should be phased out.

Improve job-search incentives in the unemployment benefit system

Unemployment benefit duration is not limited in time, while the level of benefits barely declines over the unemployment spell, reducing job-search incentives and effectively leading to early exit from the labour market.

Actions taken: No action taken.

Recommendations: Unemployment benefits should be reduced over the unemployment spell to raise job-search incentives. Initial net replacement rates may have to go up in order to make room for such a phasing-out.

BELGIUM

Structural indicators

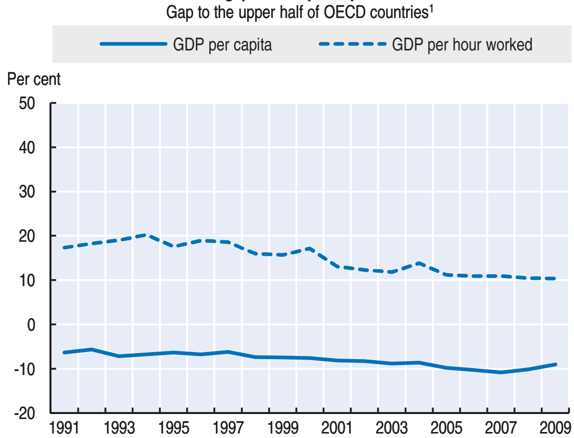
Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		1.6	1.8	1.5
Labour utilisation		0.4	0.5	0.4
of which:	Employment rate	0.4	0.5	0.3
	Average hours	0.0	0.0	0.0
Labour productivity		1.2	1.3	1.1
of which:	Capital intensity	0.5	0.5	0.5
	Multifactor productivity	0.7	0.8	0.7

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

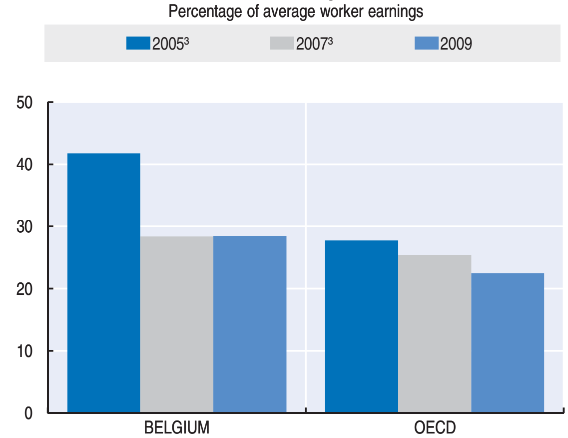
A. There has been little progress in narrowing the gap in GDP per capita

Gap to the upper half of OECD countries[1]



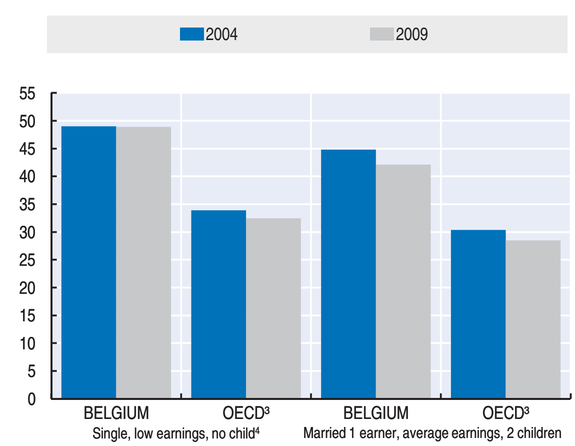
B. Implicit taxes on continued work remain higher than the OECD average[2]

Percentage of average worker earnings



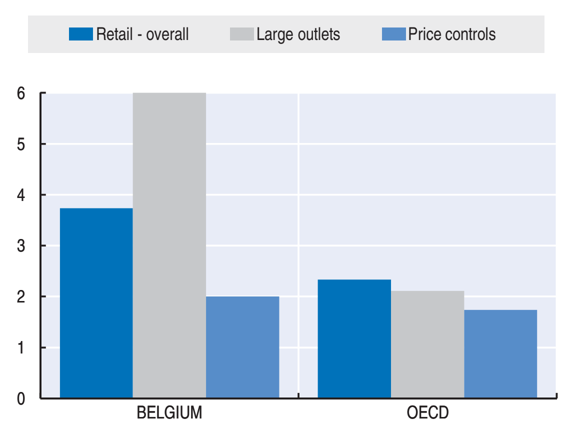
C. The average tax wedge on labour income is high

Percentage of total labour compensation



D. Regulations in the retail sector remain restrictive, 2008

Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Implicit tax on continued work in early retirement route, for 55 and 60-year-olds.
3. Average of OECD countries excluding Chile, Estonia, Israel and Slovenia.
4. Low earnings refer to two-thirds of average earnings.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: Duval, R. (2003), "The Retirement Effects of Old-Age Pension and Early Retirement Schemes in OECD Countries", OECD *Economics Department Working Papers*, No. 370 and OECD calculations; Chart C: OECD, *Taxing Wages Database*; Chart D: OECD, *Product Market Regulation Database*.

StatLink http://dx.doi.org/10.1787/888932373647

BRAZIL

The GDP per capita gap with OECD countries is now diminishing but remains large and is largely due to comparatively weak labour productivity performance reflecting in part fairly low investment rates. Beyond the recent efforts to combat inequality through the extension of anti-poverty programmes, further actions are needed in the following areas to sustain overall economic performance.

Priorities supported by indicators

Increase the quality of education at all levels

Near-full enrolment has been achieved for primary and secondary education, but student performance is comparatively low. Attainment and performance also need to be improved in private higher-education institutions.

Actions taken: Funding for basic and professional education has been raised. Conditions for student loans have been eased. An entrance examination for teaching, a National Plan for Qualification and a wage floor for professionals in public education have been established at the national level.

Recommendations: Increase the quality of education at primary and secondary levels. Expand tertiary vocational and professional training to overcome skill shortages.

Improve the efficiency of financial markets

Although they have shielded the economy during the crisis, mandated credit provisions and excessive bank reserve requirements may slow financial-market deepening and impair economy-wide efficiency over the longer term.

Actions taken: Compulsory bank reserve requirements have been strengthened further in the context of rapid credit expansion. During the crisis, the lending capacity of the public development bank, BNDES, was expanded.

Recommendations: Gradually phase out mandated credit provisions to certain sectors, including agriculture and housing, to improve resource allocation. Ease bank reserve requirements to lower intermediation costs over the medium term, in accordance with the objective of ensuring both the stability and development of financial markets.

Improve infrastructure provision

Past infrastructure programmes suffered from implementation delays. Restrictions on trade and investment hold back private investment.

Actions taken: In March 2010, the government announced a five-year investment plan with the aim of increasing private and public investment in transport, sanitation, energy and housing.

Recommendations: Reduce financial costs, the capital tax on productive investment and current expenditures in the public sector to allow higher infrastructure investment. Encourage States and municipalities to swiftly and efficiently undertake infrastructure projects. Lower regulatory uncertainties in the oil and gas sector and remove legal barriers to competition to spur private investment.

Other key priorities

Reduce distortions in the tax system

Brazil's indirect tax system is cumbersome due to its fragmentation, complexity and changing provisions. Onerous social security contributions and additional levies on enterprise payroll imply a large burden on labour income with adverse effects on employment, especially on formal jobs.

Actions taken: A reform package was introduced into Congress in 2008 to unify state-level VAT rates and bases and alleviate the burden on labour income. The tax burden on investment has been lowered.

Recommendations: The new government should follow through with the proposed reform package and secure support from State governments.

Improve incentives for formal labour force participation

Informality is decreasing but remains widespread and can be partly attributed to high labour taxes, the design of some social schemes (including the unemployment and severance insurance mechanisms) and low employability of low-skilled workers.

Actions taken: A new law entered into force in 2009 to enlarge and reinforce institutional efforts to simplify the tax and regulation systems for self-employed and micro and small companies.

Recommendations: Encourage human capital accumulation on and off the job and lower social contributions for low-paid workers to help tackle informality. Remove disincentives to formal labour force participation embedded in social programmes.

BRAZIL

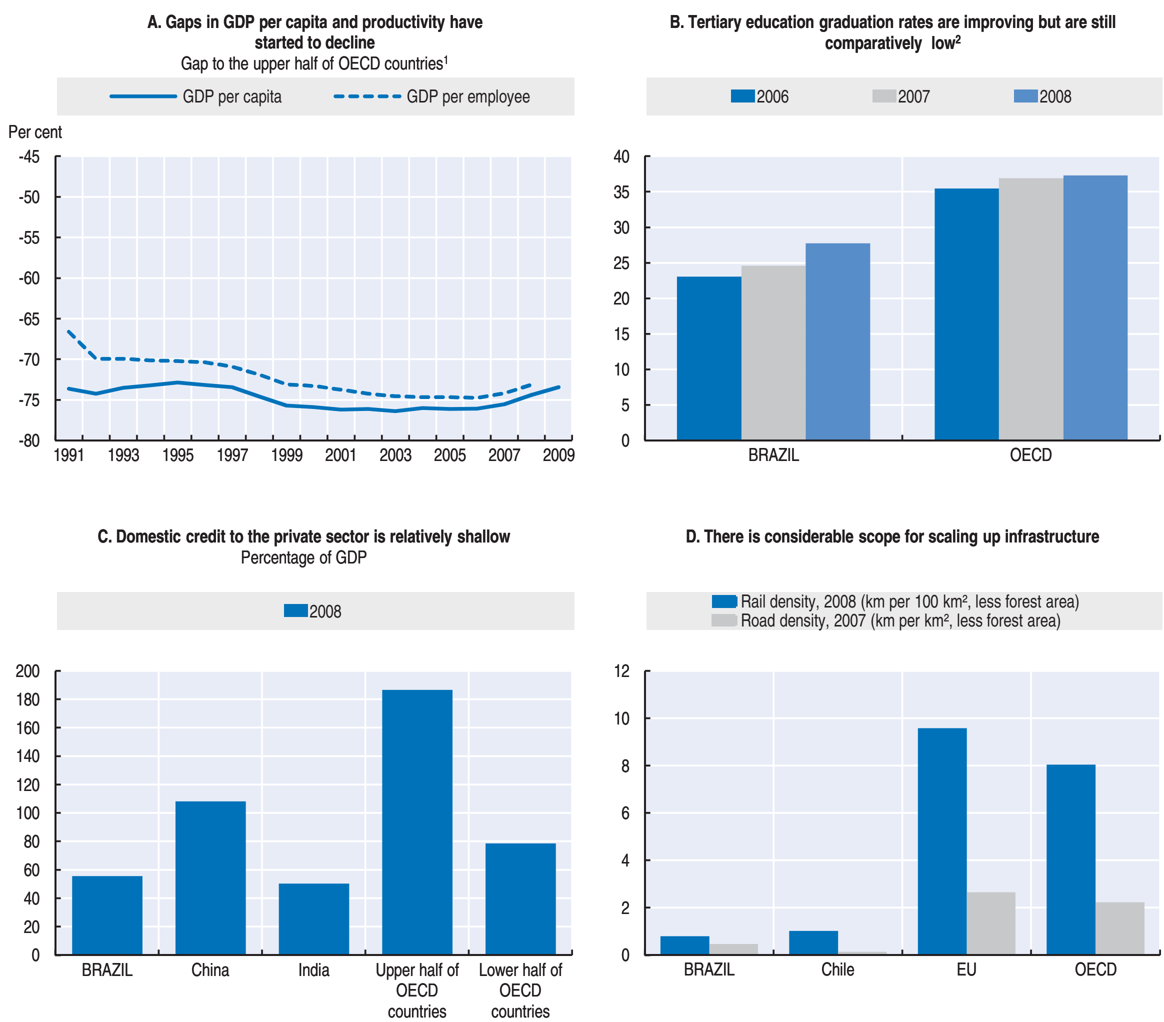
Structural indicators

Average annual trend growth rates, per cent

		1998-2008	1998-2003	2003-08
GDP per capita		2.1	0.5	3.6
Labour utilisation		. .	. .	. .
of which:	Employment rate	1.3	1.2	1.4
	Average hours	. .	. .	. .
Labour productivity[1]		0.7	–0.7	2.2
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

1. Labour productivity is measured as GDP per employee.

Source: Estimates based on World Bank (2010), *World Development Indicators(WDI)* and ILO (2010), *Key Indicators of the Labour Market (KILM) Databases*.



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per employee (in constant 2005 PPPs).
2. First degree graduation rates for single year of age at tertiary-type A level.

Source: Chart A: World Bank (2010), *World Development Indicators (WDI) and ILO (2010), Key Indicators of the Labour Market (KILM) Databases*; Chart B: OECD (2010), *Education at a Glance*; Charts C and D: World Bank (2010), *World Development Indicators (WDI)*.

StatLink http://dx.doi.org/10.1787/888932373666

CANADA

A small gap in GDP per capita relative to the upper half of OECD countries persists, entirely the result of relatively low labour productivity. This performance shortfall could be addressed by making further progress in the priority areas below. In other fields, the federal government is pursuing a free-trade agreement with the European Union, and provinces are making headway in pricing carbon emissions.

Priorities supported by indicators

Reduce barriers to competition

Productivity-reducing barriers to competition remain in network industries, retail and professional services.

Actions taken: There has been little progress in integrating regional/provincial electricity markets and opening them up to competition, and no progress in liberalising postal services. In 2009, Canadian governments revised the Labour Mobility Chapter of the Agreement on Internal Trade.

Recommendations: Move towards more integrated and competitive electricity markets. Eliminate Canada Post's legally protected monopoly. Take steps to apply the renegotiated Labour Mobility Chapter as broadly as possible, and review aspects of the regulation of professions and skilled trades that still hinder interprovincial mobility and competition.

Reduce barriers to foreign direct investment

Restrictions on foreign direct investment, remain higher than in the majority of OECD countries, discouraging productivity-enhancing capital deepening.

Actions taken: An agreement to provide airlines unlimited freedom to operate direct services between any point in Canada and the 27 European Union countries was signed in December 2009. In 2010 the existing restrictions on foreign ownership of Canadian satellites were removed.

Recommendations: Open up the telecommunications sector to foreign competition. Relax foreign ownership restrictions in the air transport sector to unlock the full potential benefits of the recent Canada-EU agreement, including cabotage.

Shift taxation towards consumption

The corporate income tax rate is being reduced but the overall tax mix could be made more growth-friendly.

Actions taken: The federal corporate income tax rate began decreasing in 2008 and further reductions are planned at the federal level and in various provinces through July 2013. Provincial capital taxes are being eliminated. Provincial retail sales taxes have been harmonised with the federal GST (value-added tax) in Ontario and British Columbia.

Recommendations: Implement all planned reductions in corporate tax rates. Raise value-added tax rates and offset the impacts with further personal income tax cuts. Harmonise sales taxes with the GST in provinces that still retain their own retail sales taxes (Prince Edward Island, Manitoba and Saskatchewan).

Other key priorities

Improve R&D support policies

The Canadian business sector has a low propensity to innovate relative to other OECD countries and a poor record at the commercialisation of technical advances, hurting productivity growth.

Actions taken: In 2010 the federal government stepped up funding for a number of programmes that support business innovation and commercialisation, removed impediments to international venture capital and announced a comprehensive review of all federal support for R&D to improve its contribution to innovation and economic opportunities for business.

Recommendations: Carry out full cost-benefit analyses of current R&D support programmes as part of the review and use the results to re-focus government funding toward those programmes that have the highest returns.

Reform the unemployment insurance system

Automatic variation of Employment Insurance (EI) parameters depending on regional labour-market conditions hinders labour mobility and entrenches high unemployment in some regions.

Actions taken: No action taken.

Recommendations: Introduce employer experience rating into EI or scale back access to it for seasonal and temporary workers in high unemployment regions.

CANADA

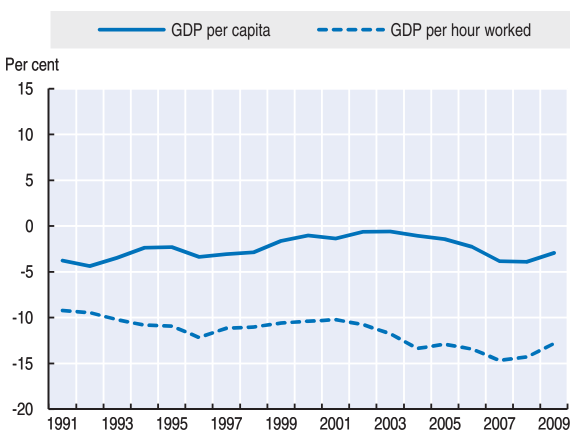
Structural indicators

Average annual trend growth rates, per cent

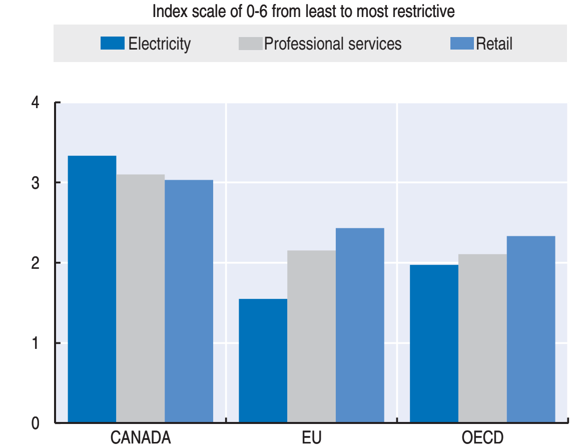
		1999-2009	1999-2004	2004-09
GDP per capita		1.6	2.0	1.3
Labour utilisation		0.5	0.7	0.4
of which:	Employment rate	0.7	0.9	0.5
	Average hours	–0.2	–0.2	–0.1
Labour productivity		1.1	1.3	0.9
of which:	Capital intensity	0.9	0.9	1.0
	Multifactor productivity	0.2	0.4	–0.1

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

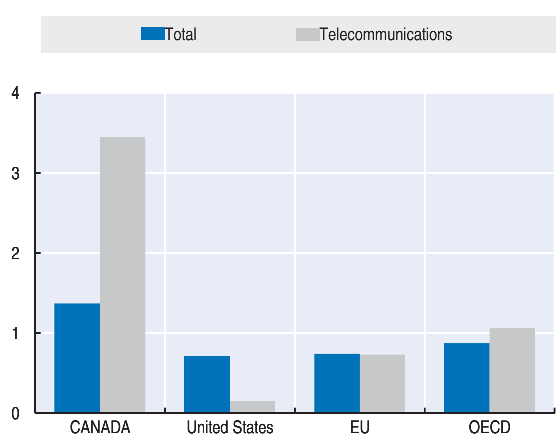
A. The small gap in living standards persists
Gap to the upper half of OECD countries[1]



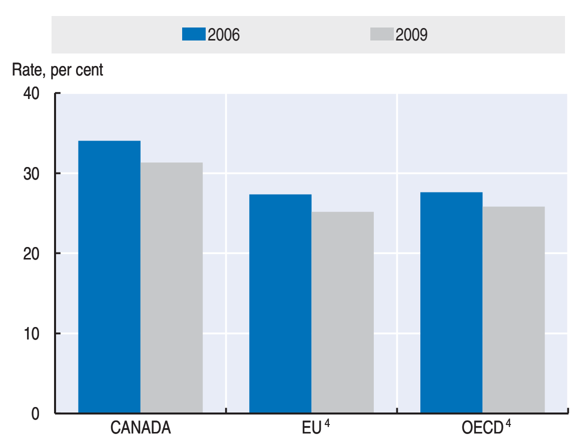
B. Significant barriers to competiton remain in several sectors, 2008
Index scale of 0-6 from least to most restrictive



C. Barriers to foreign direct investment are relatively high, 2006[2]
Index scale of 0-6 from least to most restrictive



D. The corporate income tax rate has been reduced and will be cut further[3]



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. The FDI regulation index looks only at statutory restrictions and does not assess the manner in which they are implemented.
3. Combined central and sub-central (statutory) corporate income tax rate.
4. Average of European countries in the OECD. EU and OECD averages exclude Estonia in 2006 and 2009, Israel and Slovenia in 2006.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Charts B: OECD, *Product Market Regulation Database*; Chart C: Koyama, T. and S. S. Golub (2006), "OECD's FDI Regulatory Restrictiveness Index: Revision and Extension to More Economies", *OECD Economics Department Working Papers*, No. 525; Chart D: OECD, *Tax Database*.

StatLink http://dx.doi.org/10.1787/888932373685

CHILE

Chile has one of the largest GDP per capita gaps with respect to the upper half of OECD countries, primarily reflecting lower labour productivity. Convergence has slowed over the past decade, mainly owing to weak productivity growth. This performance shortfall could be addressed by implementing further reforms in the areas below. Female labour participation and schooling outcomes are also likely be partly stimulated by the recent expansion of kindergarten places provided effective quality controls are put in place.

Priorities supported by indicators

Ease product market regulation

Burdensome business regulations and an inefficient bankruptcy procedure hold back productivity growth.

Actions taken: A law reducing red tape for small and medium-size enterprises passed Congress in early 2010. A bill reducing the administrative burden for start-ups was submitted to Congress in June 2010. A commission is developing proposals to reform bankruptcy procedures for small businesses.

Recommendations: Further reduce the administrative burden for start-ups, including by establishing a one-stop shop. Ease registration and notification requirements for entry into the retail sector. Simplify the bankruptcy law to speed up and reduce the cost of closing down failed businesses.

Improve secondary and tertiary education outcomes

Uneven quality and equity of education hampers the adoption of new technologies and productivity growth.

Actions taken: An increased voucher subsidy for poor children was introduced and selection of pupils based on ability or socio-economic background was forbidden in primary school in 2008. Accreditation for initial teacher education is now mandatory and the government is developing standards for it. Government funding for scholarships has increased by nearly 70% over 2007-09.

Recommendations: Upgrade the subject-content knowledge of teachers through richer curricula and rigorous quality assurance in initial teacher education and extended on-the-job programmes. Implement the envisaged quality assurance system for primary and secondary schools. Hold schools accountable for their pupils' progress.

Ease employment protection legislation for regular workers

Low unemployment benefits in conjunction with elevated severance pay provide weak income support for workers in case of unemployment while resulting in high hiring costs for employers, contributing to fewer jobs with regular contracts and lower productivity.

Actions taken: The government has increased the duration of unemployment benefit receipts and eased access to the insurance component of the system, including by opening it for workers on short-term contracts. This improves the protection of unemployed workers and their ability to look for jobs that are a good match, contributing to higher productivity.

Recommendations: Consider lowering relatively high severance pay for regular workers to ease adjustment of the regular workforce. In return, consider increasing unemployment benefits further after a careful evaluation of recent reforms.

Other key priorities

Strengthen policies to foster female labour participation

Low access to childhood education and care schemes hinders female labour participation, which is among the lowest across the OECD.

Actions taken: The government increased public nursery places nearly fourfold and kindergarten places for 2-3 year-olds by 50% over 2006-10.

Recommendations: Extend publicly-financed early childhood education and care further together with strong quality control, and review relatively strict part-time regulations.

Strengthen competition law

Weak competition law enforcement has curbed competition and productivity growth.

Actions taken: The competition law was reformed in 2009.

Recommendations: Implement the new competition law effectively by ensuring that the National Economic Prosecutor receives sufficient resources, by making price fixing a criminal offence, and by reviewing the maximum level of fines, which remain too low.

CHILE

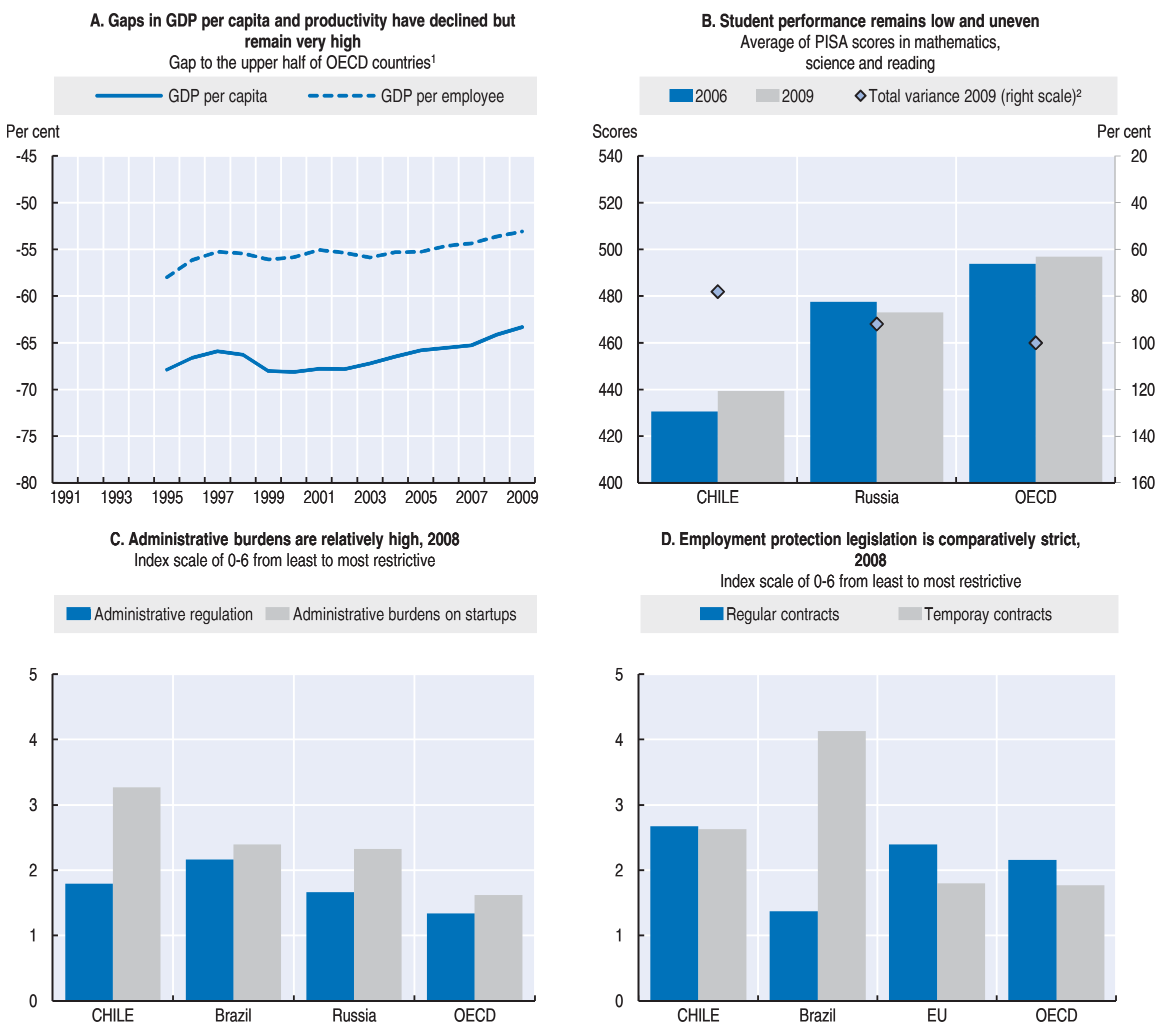
Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		2.7	2.4	2.9
Labour utilisation		. .	. .	. .
of which:	Employment rate	1.3	0.9	1.7
	Average hours	. .	. .	. .
Labour productivity[1]		1.4	1.5	1.2
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

1. Labour productivity is measured as GDP per employee.

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database*.



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per employee (in constant 2005 PPPs).
2. The variance components, in reading performance only, were estimated for all students in participating countries with data on socio-economic background and study programmes. The variance is calculated, as a percentage of the average OECD variance, from the square of the standard deviation for the students used in the analysis.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *PISA 2009 Database*; Chart C: OECD, *Product Market Regulation Database*; Chart D: OECD, *Employment Database*.

StatLink http://dx.doi.org/10.1787/888932373704

CHINA

GDP per capita has soared over the past five years, rising by close to 50% cumulatively, thereby substantially narrowing the wide gap with OECD countries. As employment rates remain quite high the difference in income per capita essentially reflects lower productivity. A broad range of reforms have occurred in recent years, supporting rapid productivity gains, though progress in the following areas would help to ensure that this continues.

Priorities supported by indicators

Reduce the importance of the state-owned sector in the economy

The total factor productivity of state-owned enterprises is lower than that of privately-funded companies, and many state-owned companies are still encountering losses. Relative to OECD countries, the role of state-owned enterprises is high, especially in large parts of the services sector, harming efficiency.

Actions taken: The government issued 36 guidelines for supporting and guiding non-public economic development in April 2010, which encouraged private investment in railways, power, telecommunications and rural banks. State-controlled companies are expected to withdraw from some competitive sectors and concentrate on sectors regarded as key, such as coal, petroleum and metals.

Recommendations: The formation of large "private equity" firms should no longer have to be approved by the government, in order to increase the funds available for restructuring poorly performing state-owned companies.

Improve educational attainment

The graduation rates in upper secondary and tertiary education are well below those in OECD countries. Moreover, there are large regional disparities in school attendance.

Actions taken: Public spending on education rose from 2.7% to 3.5% of GDP between 2004 and 2008 and may reach 4% in 2012. In April 2010, the government introduced a new long-term strategy designed to improve schooling for students under 6 and over 15. The quality of teacher training will be improved and entrance methods for higher education changed to reduce the weight of memory-based tests.

Recommendations: Inequalities in the provision of education need to be reduced both regionally and within urban areas. Quick implementation of the provisions for improving migrant education is important.

Reduce administrative burdens on companies

The time taken to form companies and obtain regulatory permits is unduly long, deterring the entry of new firms and impairing competition.

Actions taken: The threshold beyond which an investment project requires central government permission has been raised.

Recommendations: Government institutions should be required to conduct a regulatory impact analysis before introducing new rules, and should progressively review all regulations.

Other key priorities

Reduce barriers to urbanisation

Income differentials between rural and urban incomes are very large, a result of significant barriers to migration. Further enabling reallocation of labour to high-productivity sectors of the economy should help boost productivity, as would a reduction in human capital differentials across the country.

Actions taken: Comprehensive health insurance and social assistance systems have been introduced in the countryside in 2009, while a new pension scheme is now being rolled out. Pilot studies are underway to reform the length of land use rights and household registration laws, potentially increasing labour mobility.

Recommendations: Social expenditure should be further increased to provide broader coverage and a stronger social safety net. Provisions of the 2003 Land Management Law need to be fully implemented to give all farmers full documentation for their rights, thus widening the rental market. The length of the use rights should be extended and household registration laws revised.

Further enhance the rule of law

The level of protection of IPRs is low by international standards and the efficacy of contract enforcement procedures varies across the country.

Actions taken: In June 2008, a new IPR strategy was introduced and has resulted in a new Patent Law and a draft revision to the Trademarks Law. Judicial hearings for IPR violation cases are to be concentrated in selected courts. Enforcement has begun to be stepped up.

Recommendations: The effectiveness of enforcement should be enhanced further through the strengthening of the judicial institutions.

CHINA

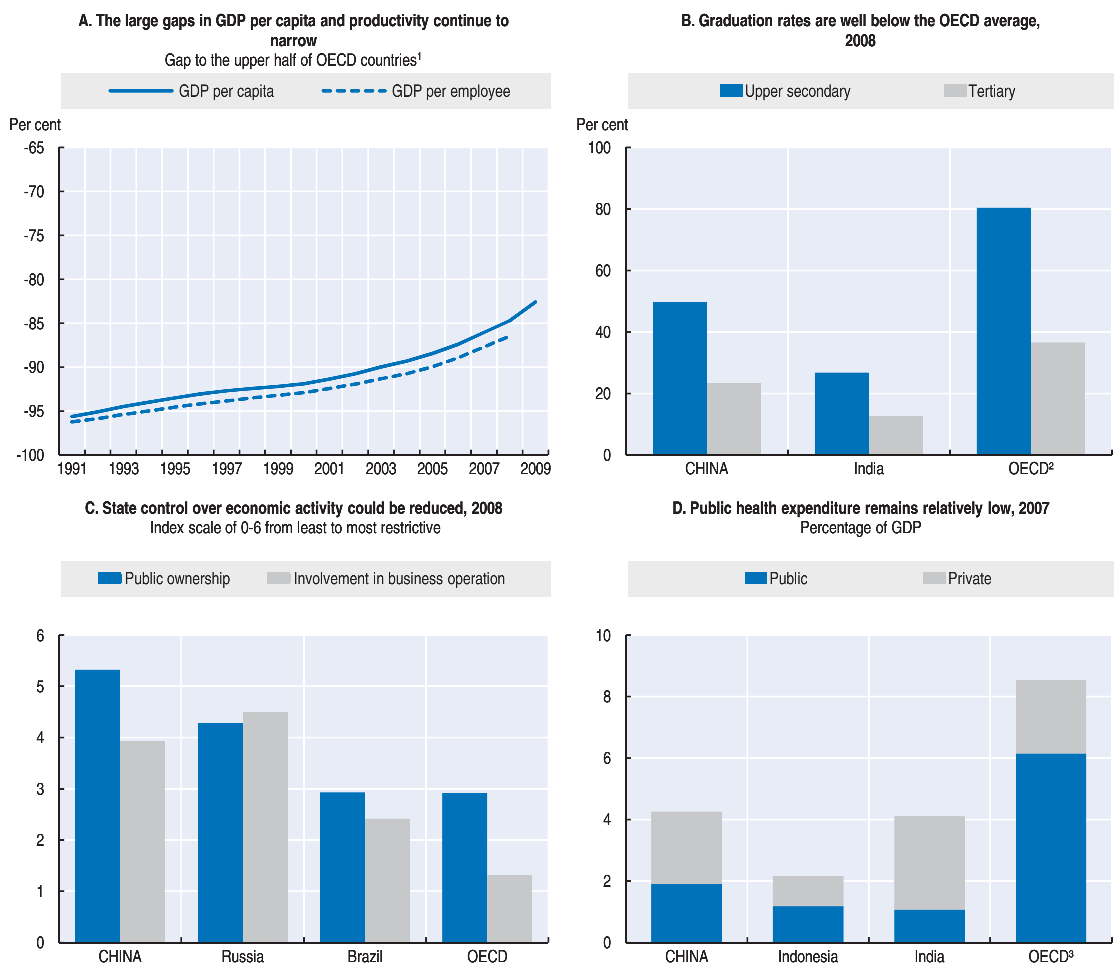
Structural indicators

Average annual trend growth rates, per cent

		1998-2008	1998-2003	2003-08
GDP per capita		9.4	7.9	10.9
Labour utilisation		. .	. .	. .
of which:	Employment rate	0.5	0.5	0.4
	Average hours	. .	. .	. .
Labour productivity[1]		8.9	7.4	10.5
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

1. Labour productivity is measured as GDP per employee.

Source: Estimates based on World Bank (2010), *World Development Indicators (WDI)* and ILO (2010), *Key Indicators of the Labour Market (KILM) Databases*.



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per employee (in constant 2005 PPPs).
2. For upper secondary education, average of OECD countries excluding Australia, Austria, Belgium, Estonia, France and the Netherlands; for tertiary education, excluding Belgium, Chile, Estonia, France and Korea.
3. Average of OECD countries excluding Chile, Estonia, Israel and Slovenia.

Source: Chart A: World Bank (2010), *World Development Indicators (WDI)* and ILO (2010), *Key Indicators of the Labour Market (KILM) Databases*; Chart B: OECD (2010), *Education at a Glance*; *China Statistical Yearbook* and *India National Sample Survey* (2007/8); Chart C: OECD, *Product Market Regulation Database*; Chart D: World Bank (2010), *World Development Indicators (WDI)*.

StatLink http://dx.doi.org/10.1787/888932373723

CZECH REPUBLIC

Several years of strong growth prior to the crisis have steadily narrowed the gaps in GDP per capita and labour productivity vis-à-vis *the upper half of OECD countries, yet both remain considerable, notably the productivity gap. Progress has been achieved in improving the business environment by greater use of information technologies, but further actions are needed in the following areas.*

Priorities supported by indicators

Relax employment protection legislation

Strict employment protection legislation discourages businesses from hiring regular workers.

Actions taken: A new labour code came into force in 2007, bringing some aspects of flexibility such as short-time working schemes that were widely used during the recent downturn.

Recommendations: Link severance pay and the notice period to the length of job tenure and relax dismissal procedures.

Enhance education outcomes

Education outcomes for 15 year-olds, as assessed by PISA scores, have worsened. Also, streaming of pupils in secondary schools happens from age 11, hampering social mobility and human capital accumulation. Despite considerable progress, tertiary education graduation rates remain slightly below the OECD average.

Actions taken: A blueprint for reform of tertiary education was published in 2009, calling for fees with income contingent loan arrangements as well as changes to the governance of universities, but no action has been taken yet. No action taken on early streaming in secondary education.

Recommendations: End the too-early selection process in secondary education, enhance monitoring of and responsibility of schools for education outcomes. Implement proposals for tertiary education fees together with income contingent loans.

Reduce barriers to business entry

While regulation of the business environment has been eased, it is still more stringent than in the average OECD country, harming productivity.

Actions taken: A new bankruptcy law and administrative one-stop shops for registering a business have been implemented together with simplified and standardised registration forms from 2006. Also, notification of sole proprietors has been largely streamlined.

Recommendations: Reduce minimum capital requirements for business start-ups together with speeding up and cutting the costs of judicial proceedings for contract and bankruptcy enforcement. Also, strengthen competition in electricity and telecommunications through stronger vigilance against possible exploitation of market dominance.

Other key priorities

Improve efficiency in public expenditure

The publicly-funded health care system is in need of efficiency improvements, all the more so because spending pressures stemming from rapid population ageing threaten long-run fiscal sustainability. Local government remains fragmented and public procurement ineffective, hampering cost-effectiveness.

Actions taken: A blueprint for reform has been presented but apart from health care fees introduced in 2008, no systemic action taken. Incentives to encourage efficiency gains in provision of local government services have not been enhanced.

Recommendations: Implement reforms in health care as well as measures to enhance efficiency at local and central government levels in areas such as public procurement.

Reform the tax-benefit system

Interactions between the tax and benefit systems result in work disincentives for low-income and second earners.

Actions taken: Introduction of the flat tax together with increased tax credit reduced the average effective tax rate for most households. At the same time family benefits became more generous and are now withdrawn at lower income levels. This has increased average effective tax rates for second earners and translates into spikes in marginal effective tax rates for others.

Recommendations: Reduce activity disincentives for low-income groups and second earners by reviewing the benefit structure and ensuring better coordination of tax and benefit regulations across the government.

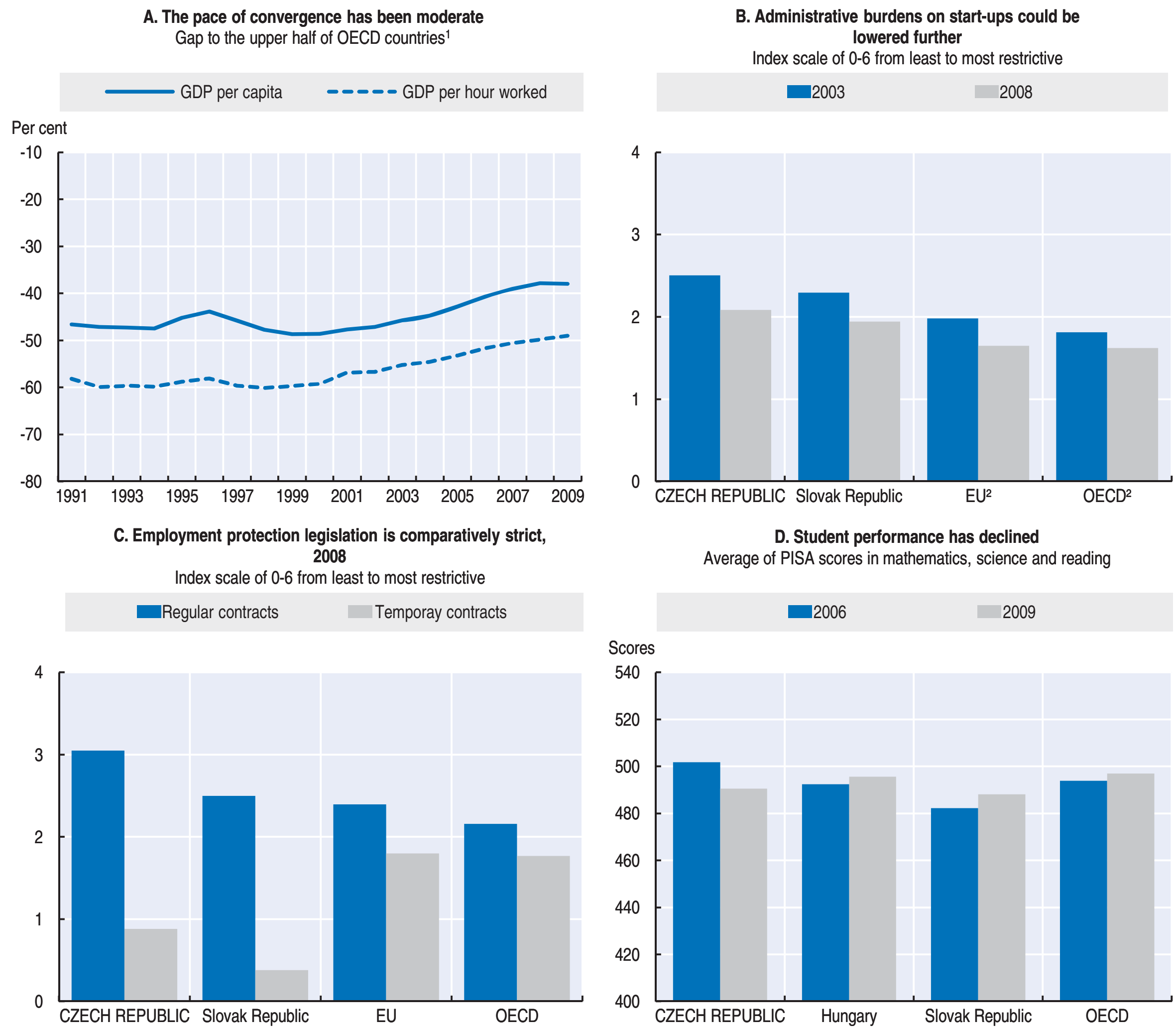
CZECH REPUBLIC

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		3.3	3.4	3.2
Labour utilisation		–0.2	–0.3	–0.1
of which:	Employment rate	0.2	0.1	0.4
	Average hours	–0.4	–0.4	–0.4
Labour productivity		3.5	3.7	3.2
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Average of European countries in the OECD. In 2003, EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: *Product Market Regulation Database*; Chart C: OECD, *Employment Database*; Chart D: OECD, *Pisa 2009 Database*.

StatLink http://dx.doi.org/10.1787/888932373742

DENMARK

The income gap vis-à-vis *the upper half of OECD countries has widened over the past decade, with rising labour utilisation more than offset by lower productivity growth. Employment rates are high but working hours remain low. Reforms over the past few years have notably focused on raising labour supply, and on fostering green growth including through policies to reduce greenhouse gases emissions. However more needs to be done in the areas below.*

Priorities supported by indicators

Improve the efficiency of the education system

Weaknesses at various levels of the education system have contributed to the labour productivity slowdown. The overall international student test score is just above the OECD average, the drop-out rate from upper secondary education is high and so is the age of completion of tertiary education.

Actions taken: From 2009, the grade point average is raised for students who apply for university within the two years after completion of upper secondary school, making their access to tertiary education easier.

Recommendations: Strengthen the educational content and enhance the culture of evaluation of compulsory education. Target the 10^{th} Form (the optional 10^{th} year of schooling before upper secondary school) towards the weakest students. Consider introducing tuition charges in tertiary education together with loans with income-contingent repayment.

Reform sickness/leave and disability benefit schemes

Not only is Denmark still operating an early retirement scheme, but the share of the working-age population that receives sickness/leave and disability benefits remains also high, reducing labour force participation.

Actions taken: In 2009 the Parliament adopted new rules for sickness/leave that put emphasis on rehabilitation.

Recommendations: Increase incentives to return to ordinary employment for the sick and disabled with some ability to work, particularly by reducing subsidies to the disabled employment programme (*Fleksjob*) which have created some lock-in effects.

Reduce marginal tax rates on labour

The top marginal tax rate is among the highest in the OECD and concerns workers with incomes only modestly above average earnings, contributing to low average working hours.

Actions taken: In 2009, the Parliament adopted a tax reform lowering the top marginal income tax rate. Income tax thresholds have also been raised even though the government finally decided in May 2010 to limit these increases through 2013 as part of its fiscal consolidation plan.

Recommendations: Continue to cut income taxes by focusing on lowering the top marginal tax rate or increasing its threshold while restraining public expenditure growth.

Other key priorities

Enhance the competition framework and relax product market regulation

Although product markets are relatively lightly regulated, productivity would be boosted by enhancing competition in some sectors, notably retail trade and publicly-funded services.

Actions taken: In 2010, the Parliament adopted legislation that broadens the set of mergers subject to scrutiny by the authorities, strengthens the sanctions for violation of procurement rules and liberalises the market for books. Regulations of opening hours in the retail sector have been eased since July 2010. No significant action has been taken in publicly-funded services.

Recommendations: Enhance competition by removing discretion in local government planning and continuing with privatisation and outsourcing of publicly-funded services.

Reduce housing subsidies and abolish rent regulation

Rent regulation remains very strict and all forms of housing receive direct and indirect tax subsidies, hindering labour market mobility and thereby productivity.

Actions taken: The 200 tax reform will reduce the value of the mortgage interest rate deduction from income taxation starting from 2012. No action has been taken on rent regulation.

Recommendations: Ease rent regulations, cut housing subsidies and raise housing taxation.

DENMARK

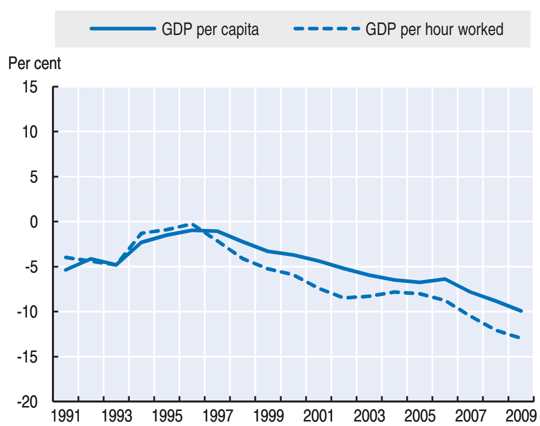
Structural indicators

Average annual trend growth rates, per cent

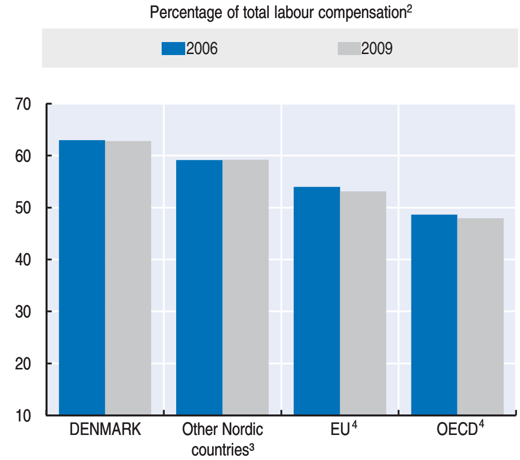
		1999-2009	1999-2004	2004-09
GDP per capita		1.3	1.4	1.2
Labour utilisation		0.5	0.6	0.5
of which:	Employment rate	0.2	0.2	0.3
	Average hours	0.3	0.4	0.2
Labour productivity		0.8	0.9	0.7
of which:	Capital intensity	0.9	0.9	1.0
	Multifactor productivity	–0.2	0.0	–0.3

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database*.

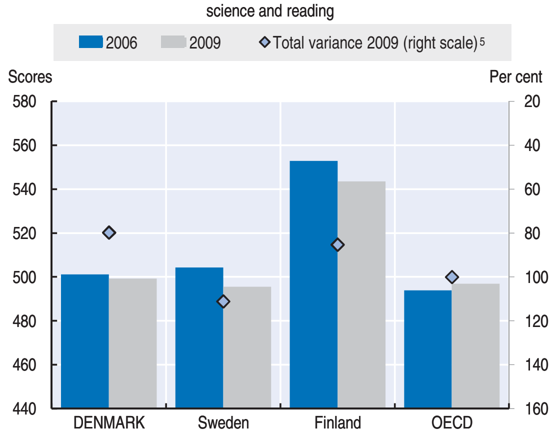
A. Gaps in GDP per capita and productivity have widened
Gap to the upper half of OECD countries[1]



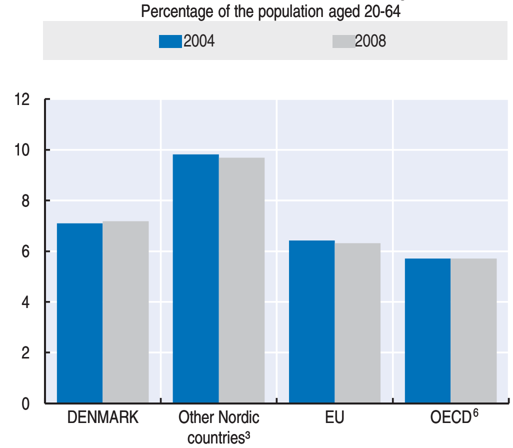
B. The marginal tax wedge on high incomes is still substantial
Percentage of total labour compensation[2]



C. Student performance could be improved
Average of PISA scores in mathematics, science and reading



D. The share of working-age population receiving disability benefits remains above the OECD average
Percentage of the population aged 20-64



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Evaluated at 200% of average earnings for a single person with no child.
3. Average of Finland, Norway and Sweden.
4. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.
5. The variance components, in reading performance only, were estimated for all students in participating countries with data on socio-economic background and study programmes. The variance is calculated, as a percentage of the average OECD variance, from the square of the standard deviation for the students used in the analysis.
6. Excluding Chile.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No.88 *Databases*; Chart B: OECD, *Taxing Wages Database*; Chart C: OECD, *PISA 2009 Database*; Chart D: OECD (2010), *Sickness, Disability and Work: Breaking the Barriers: A Synthesis of Findings across OECD Countries*.

StatLink http://dx.doi.org/10.1787/888932373761

ESTONIA

There has been rapid catch-up in the wake of EU entry, but the large gap in GDP per capita vis-à-vis *the upper half of OECD countries has widened again recently. This gap in living standards reflects a productivity shortfall, while labour utilisation is relatively high. To reach a higher trend productivity growth rate, structural reforms in the areas below are needed.*

Priorities supported by indicators

Reduce entry barriers in network industries

Due to energy security concerns, barriers to entry in network industries remain high, with detrimental effects on economic efficiency.

Actions taken: Interconnection capacity with the Nordic electricity market has been increased and electricity generation from the only domestic energy source (oil shale production) is being upgraded on environmental grounds.

Recommendations: Open the electricity market for more suppliers. Use more market incentives to increase energy efficiency, including a better public/private mix in passenger transport.

Reduce administrative burdens on businesses

Although regulatory procedures are more streamlined and transparent than those of regional peers, they are more burdensome than in the average OECD country. Such remaining regulatory and administrative opacity in the business environment hampers entrepreneurship and productivity.

Actions taken: No action taken.

Recommendations: Consider whether restrictions on land purchases by non-EU citizens for strategic reasons can be relaxed for permanent residents.

Improve the attractiveness for FDI in export-oriented manufacturing

Barriers to foreign ownership have been reduced, but still exceed EU-21 levels and hamper FDI flows, technological spillovers and productivity growth in the tradable sector.

Actions taken: Enterprise Estonia was created, merging various state agencies for supporting businesses.

Recommendations: Monitor the effectiveness of implemented policies, and in particular that of the grants-based approach which requires the ability to pick winners.

Other key priorities

Improve the quantity and quality of placement services

Given the current elevated levels of unemployment, the risk of long-term unemployment is increasing.

Actions taken: The employment office (under administration of the unemployment fund) has received more funds to deal with the surge of unemployment after the crisis struck.

Recommendations: Further improve the capacity of the unemployment fund to provide efficient job-search assistance, including for those unemployed whose benefits have expired.

Improve private bankruptcy procedures

The recent rapid credit growth during the boom years results in households trapped in unaffordable loan-financed housing, thus constraining domestic consumption and growth.

Actions taken: No action taken.

Recommendations: Actively manage restructuring, including relocating owner-occupiers to smaller, more affordable housing. Make sure banks cannot develop and exercise monopsonistic practices, such as exorbitant interest rates or unfair fee structures. Review private bankruptcy procedures.

ESTONIA

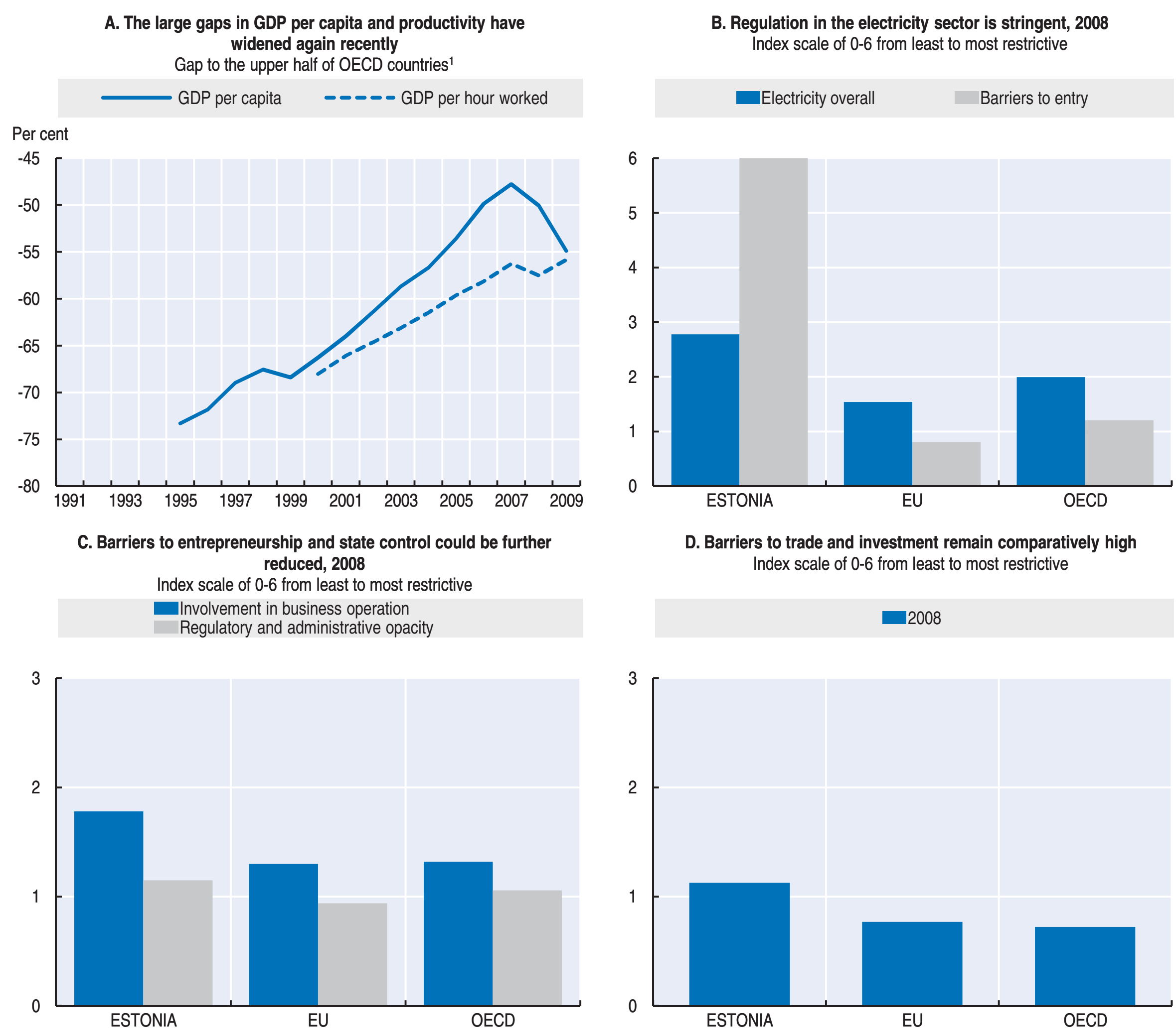
Structural indicators

Average annual trend growth rates, per cent

		2000-2009	2000-2004	2004-09
GDP per capita		5.5	7.6	3.8
Labour utilisation		..	..	..
of which:	Employment rate	0.5	1.3	0.0
	Average hours	..	..	.
Labour productivity[1]		4.9	6.3	3.9
of which:	Capital intensity	..	..	..
	Multifactor productivity	..	..	..

1. Labour productivity is measured as GDP per employee.

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Charts B, C and D: OECD, *Product Market Regulation Database.*

StatLink http://dx.doi.org/10.1787/888932373780

EUROPEAN UNION

There is a substantial income gap relative to the upper half of the OECD as productivity and labour utilisation levels remain below the top performers. Progress has been made in financial sector reform, notably in the area of macro prudential regulation. Structural reforms in the following areas are needed to limit the medium and long-term effects of the crisis on potential output.

Priorities supported by indicators

Increase competition in the services sector

Low competitive pressures in the services sector hold back productivity.

Actions taken: The 2006 Services Directive should bring a marked improvement in competition. Transposition of the Directive is well advanced but remains incomplete across EU countries. A Single European Payments Area is being created.

Recommendations: Ensure complete and effective implementation of the Services Directive and proper enforcement of its legal and practical provisions. Ensure that the payments area is completed swiftly.

Raise competition in network industries

Competition in network industries is hindered by the incompleteness of the single market and regulatory barriers.

Actions taken: Postal services will be fully liberalised in 2012.

Recommendations: Strengthen the evidence base for single market initiatives by identifying specific barriers to competition and efficiency. Ensure EU-level measures are fully implemented in national markets, including functional separation of supply and production activities in energy markets. Push ahead with initiatives to reform and integrate the transport, postal, telecommunications, port services and energy markets.

Reduce producer support to agriculture

Agricultural support under the Common Agricultural Policy (CAP) is distorting and thereby harmful for overall productivity. It also disproportionately benefits large and efficient farms.

Actions taken: CAP reforms have significantly reduced linkages between payments and production. Milk quotas are to be phased out by 2015. The use of price support has been scaled back for many agricultural commodities. However, the re-introduction of agricultural export subsidies for dairy produce in 2009 was a step back.

Recommendations: Full decoupling of payment should be extended to livestock meat production. Payments across agricultural producers should be further decoupled from production. Barriers to market access for non-EU countries should be reduced. Support prices should be lowered and biofuels subsidies reduced.

Other key priorities

Reform financial regulation and deepen market integration

Financial market regulation needs to be more effective to promote stability and efficiency.

Actions taken: A wide range of reforms is underway including measures to strengthen capital requirements, liquidity management, deposit guarantee schemes, and oversight of credit rating agencies and alternative investment funds. A new framework for cross-border supervision and crisis management is being put in place.

Recommendations: New regulation should be designed to promote a robust and less cyclical financial system. Newly-created European supervisory bodies should be given sufficient powers and resources to ensure effective cross-country supervision and management of systematic risk. More should be done to integrate retail markets.

Improve the functioning of the labour market

Structural unemployment is high, while hours worked and labour force participation are relatively low.

Actions taken: The European Economic Recovery Plan targeted European Social Fund Support spending on labour market programmes. The Europe 2020 Agenda sets the objective of an employment rate of 75% for those aged 20-64.

Recommendations: EU labour market objectives can primarily be achieved using national policy instruments, but reforms can also be facilitated by EU-level surveillance and peer pressure. Measures at the EU level can contribute to facilitating labour mobility by increasing the portability of occupational pension and social welfare benefit rights.

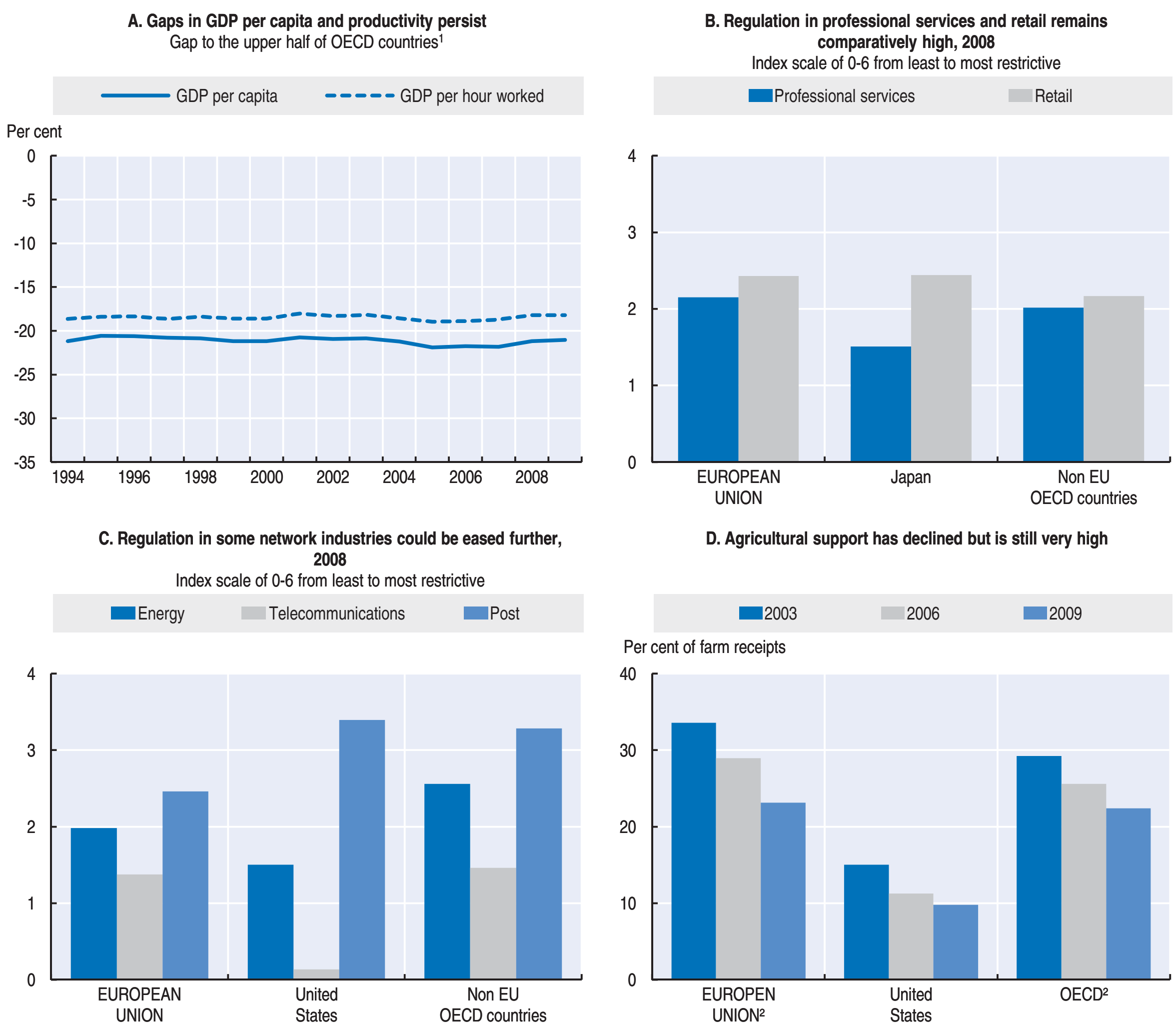
EUROPEAN UNION

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-200	2004-09
GDP per capita		1.6	2.0	1.3
Labour utilisation		0.1	0.2	0.1
of which:	Employment rate	0.5	0.6	0.3
	Average hours	–0.3	–0.4	–0.2
Labour productivity		1.5	1.8	1.2
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Charts B and C: *Product Market Regulation Database*; Chart D: OECD, *Producer and Consumer Support Estimates Database.*

StatLink http://dx.doi.org/10.1787/888932373799

FINLAND

The GDP per capita gap vis-à-vis *the upper half of OECD countries narrowed until 2008 but widened again during the recession. This gap mainly reflects lower labour productivity, but labour resource utilisation is also below the best performing countries. Recent reforms have sought to strengthen labour force participation, stem the increase in long-term unemployment and improve the efficiency of public service provision. Additional reforms are still needed in the following areas.*

Priorities supported by indicators

Reduce disincentives to work at older ages

Implicit taxes on continued work are still high, contributing to low employment rates among older workers compared with other Nordic countries.

Actions taken: The government and stakeholder organisations agreed in 2009 to gradually (until 2025) increase the average effective retirement age by three years.

Recommendations: Implement measures to ensure reaching the 2025 target by raising the minimum statutory retirement age, reviewing the disability pension system and fully closing the unemployment pathway into retirement. Strengthen work incentives for older workers by increasing pension accrual rates after 65 and extending the actuarial adjustment of pensions to the full working life, including the period after the minimum retirement age.

Reform the unemployment benefit system

High benefit replacement rates are reducing work incentives.

Actions taken: Measures to fight the recession during the economic crisis have weakened work incentives. Various benefits (maternity, parental and sickness allowance) have been increased and an unemployment benefit supplement for laid-off workers was introduced in July 2009.

Recommendations: Reduce replacement rates and taper them off throughout the unemployment spell when the recovery firms, but announce as early as possible. Ensure earlier mandatory activation for the unemployed.

Reduce the tax wedge on labour income and shift the structure of taxation towards property and consumption

Marginal tax wedges on labour income remain high, hampering improvements in labour utilisation.

Actions taken: Average taxes on earnings have been lowered across income classes. The revenue loss is being offset by an increase in most VAT rates by one percentage point, with the exception of VAT on food which has been lowered by 10 percentage points.

Recommendations: Continue to lower the taxation of labour to improve work incentives and offset the revenue loss with additional receipts from indirect and property taxes. Increase property tax rates but also align assessment values with market valuations. Raise the revenue efficiency of the VAT by eliminating reduced rates.

Other key priorities

Increase productivity in municipalities

Municipalities' productivity is declining which weighs on public finances.

Actions taken: Municipal merger legislation has been renewed and productivity programmes promoted.

Recommendations: Open up the municipal purchasing of non-core services to competitive bidding by introducing more mainstreaming of outsourcing policy, promote municipal mergers and municipal-level productivity programmes, with increased reliance on benchmarking.

Improve the efficiency of the tertiary education system

Average tertiary study times are long and students benefit from generous and virtually open-ended financial aid.

Actions taken: The Ministry of Education is reviewing student selection procedures in Higher Education Institutions, as well as ways to speed up graduation, and is rationalising student financial aid.

Recommendations: Address inefficiencies in access to upper education and introduce tertiary tuition fees together with government student loans with income-contingent repayments.

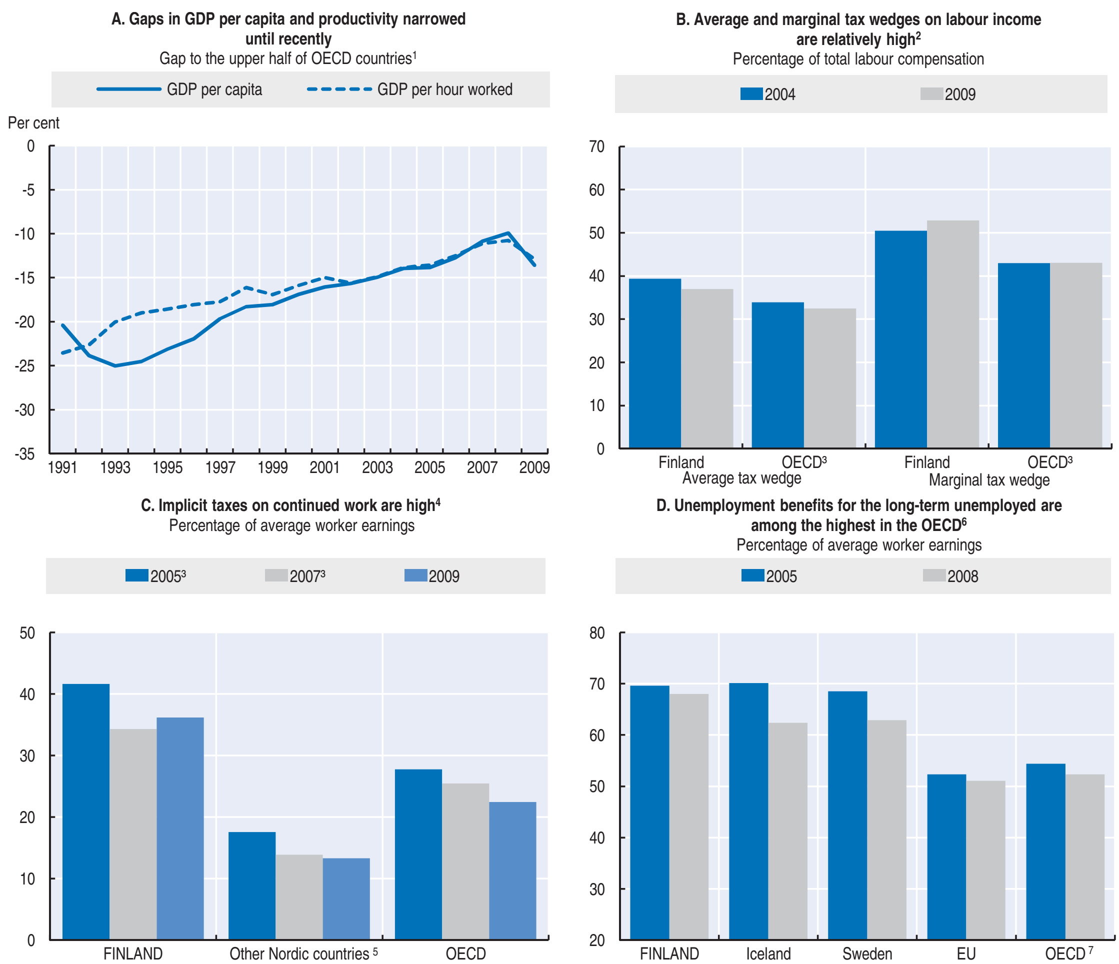
FINLAND

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		2.6	3.2	2.1
Labour utilisation		0.2	0.5	–0.1
of which:	Employment rate	0.5	0.9	0.1
	Average hours	–0.3	–0.3	–0.3
Labour productivity		2.4	2.7	2.2
of which:	Capital intensity	0.4	0.4	0.4
	Multifactor productivity	2.0	2.2	1.8

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Single person with low earnings and no child (low earnings refer to two-thirds of average earnings).
3. Average of OECD countries excluding Chile, Estonia, Israel and Slovenia.
4. Implicit tax on continued work in early retirement route, for 55 and 60-year-olds.
5. Average of Denmark, Norway and Sweden.
6. Average of net replacement rates after five years of unemployment for unemployed persons who earned 67% and 100% of average worker earnings.
7. Average of OECD countries excluding Chile and Israel.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *Taxing Wages Database*; Chart C: Duval, R. (2003), "The Retirement Effects of Old-Age Pension and Early Retirement Schemes in OECD Countries", OECD *Economics Department Working Papers*, No. 370 and OECD calculations; Chart D: OECD, *Benefits and Wages Database.*

StatLink http://dx.doi.org/10.1787/888932373818

FRANCE

The income gap relative to the upper half of OECD countries has widened since the early nineties due to weak employment outcomes, especially for youth and older workers, as well as relatively short annual hours worked. The government has enacted reforms in recent years to strengthen innovation and reduce tax disincentives to investment, but additional measures are still needed, especially in the areas below.

Priorities supported by indicators

Reduce labour market dualism

The deeply engrained segmentation reduces the ability of firms to adjust to shocks and puts pressure on outsiders to fulfil the adjustment needs of the economy, hindering productivity.

Actions taken: Apart from the development of combined work-study schemes through tax incentives and subsidies, no action taken since 2009. Mutually agreed separation has been possible since 2008.

Recommendations: Given the difficulty to promote a single, more flexible labour contract, address labour market dualism by broadening the definition of economic redundancy, simplifying layoff procedures and reducing firms' redeployment obligations. Moreover, target the work-study schemes more on the less skilled, and evaluate their efficiency regularly.

Reduce the labour tax wedge and the minimum cost of labour

High labour taxes undermine employment and the high relative minimum wage reduces job opportunities for certain labour market groups, especially young people and low-skilled workers.

Actions taken: A commission of experts was created in 2009 to provide annual advice on minimum wage increases to both social partners and the government. Consistent with its recommendations, the rise in the minimum wage has been limited to the minimum legal requirement.

Recommendations: Continue to allow the minimum cost of labour to fall relative to the average. Make the tax structure more favourable to growth by reducing direct labour taxes while cutting public spending and the least cost-effective tax expenditures, and increasing consumption, real property and inheritance taxes. Encourage social partners to put the question of age-related pay increases at the centre of wage negotiations.

Continue to reduce disincentives to work at older ages

Significant progress has been made recently, but additional actions are needed to promote seniors' employment.

Actions taken: The 2010 reform of the pension system includes an increase of 2 years in the legal retirement age and will increase participation. Companies have been induced to conclude agreements to promote seniors' employment, which might change both employers' and workers' attitudes towards working and training at older ages.

Recommendations: Work disincentives at older ages should be further reduced by: *i)* a continued phasing-out of all forms of early retirement, including through the unemployment benefit scheme; *ii)* a further increase, and an automatic link to life-expectancy gains of the contribution period; and *iii)* strengthening the return-to-work strategy by reinforcing the link between benefits, job search and participation in active measures relying on efficient employment services.

Other key priorities

Improve the quality and efficiency of the tertiary education system

The tertiary education system is segmented with universities contributing to high student drop-out rates and lacking funding although their new autonomy provides more opportunities to seek new sources of finance.

Actions taken: Public investment projects to create regional universities as "centres of excellence" have been approved.

Recommendations: Rebalance public resources between universities and *grandes écoles* and allow universities to select students. Raise tuition fees while developing income-contingent student loans, adjusting means-tested grants as necessary to ensure equitable access. Incorporate information on labour market prospects into career guidance and expand vocational education to address skill mismatches.

Reduce regulatory barriers to competition

Competition is restricted by the regulatory framework, hindering productivity and employment.

Actions taken: A fourth mobile telecommunications operator license was granted in late 2009, and contractual restrictions for mobile virtual network operators (MVNOs) were eased.

Recommendations: Remove regulatory entry barriers in potentially competitive segments of network industries. Further ease restrictions in the retail sector, especially to setting up new stores.

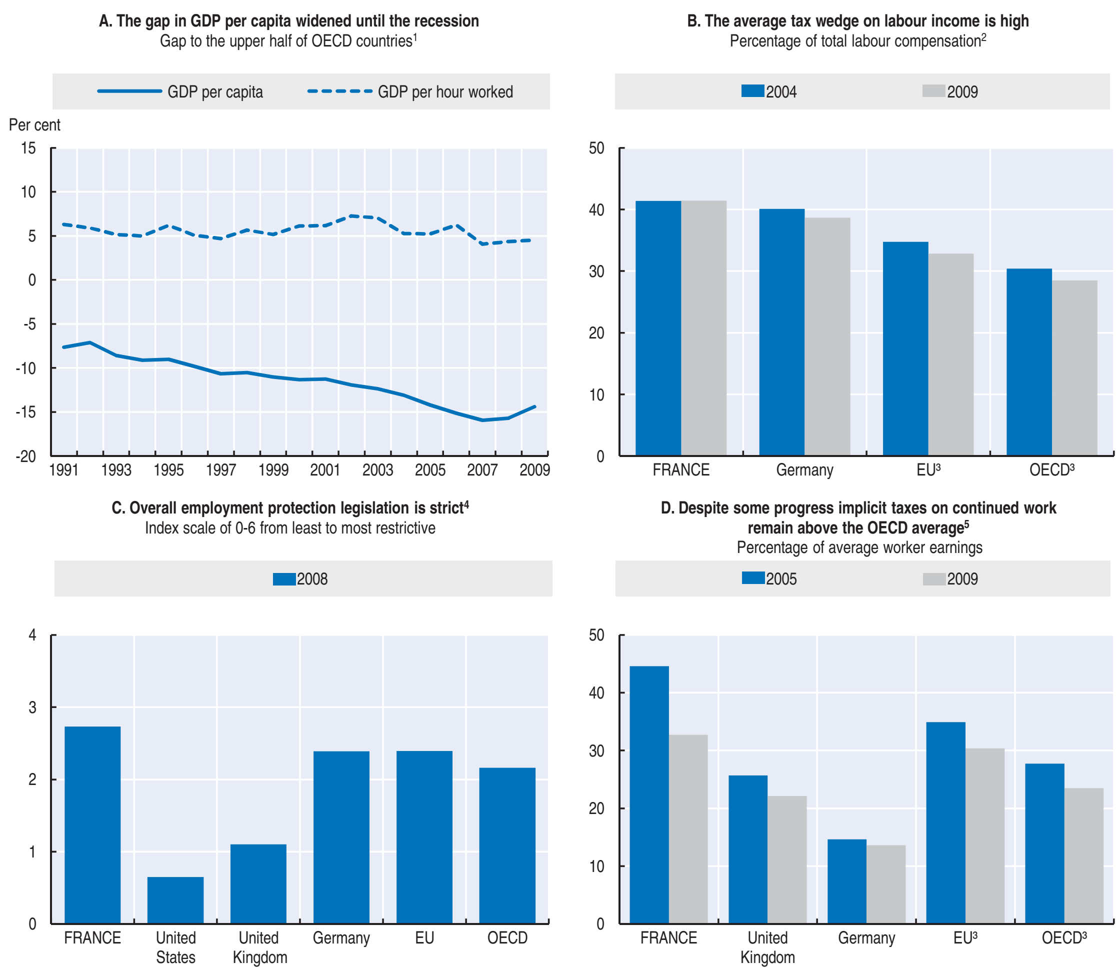
FRANCE

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		1.2	1.6	0.9
Labour utilisation		–0.2	–0.3	–0.1
of which:	Employment rate	0.2	0.3	0.0
	Average hours	–0.4	–0.6	–0.2
Labour productivity		1.5	1.9	1.1
of which:	Capital intensity	0.8	1.0	0.7
	Multifactor productivity	0.6	1.0	0.3

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. At 100% of the average worker earnings, couple with two children. Average of three situations regarding the wage of the second earner.
3. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.
4. Overall EPL is computed as a weighted sum of sub-indicators for regular contracts, temporary contracts and collective dismissals. Year 2009 for France.
5. Implicit tax on continued work in early retirement route, for 55 and 60-year-olds. Year 2010 for France.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *Taxing Wages Database*; Chart C: OECD, *Employment Database*; Chart D: Duval, R. (2003), "The Retirement Effects of Old-Age Pension and Early Retirement Schemes in OECD Countries", OECD *Economics Department Working Papers*, No. 370 and OECD calculations.

StatLink http://dx.doi.org/10.1787/888932373837

GERMANY

The GDP per capita gap relative to the upper half of OECD countries has narrowed somewhat since the mid-2000s, but a labour utilisation gap remains. Reforms of the short-time work scheme during the crisis have prevented excessive layoffs. Work incentives are also being strengthened in 2011 by phasing out the temporary supplementary benefit paid to certain long-term unemployed. However, further structural reforms are still needed in the following areas.

Priorities supported by indicators

Reduce barriers to competition in the services sector

Barriers to entrepreneurship, notably in professional services, limit competition and thereby hamper productivity growth.

Actions taken: The statutory fee schedule for architects has been adjusted and simplified in 2009.

Recommendations: Simplify the license and permit system. Ease conduct regulations for professional services, for example, by further reducing restrictions on the co-operation between professions, further liberalising prices and reassessing the need for restrictions on advertising. Simplify entry conditions into professional services by rethinking compulsory chamber membership, reducing the number of activities over which certain professions have exclusive rights and lowering education requirements for full chamber membership.

Improve tertiary education outcomes

Tertiary attainment rates remain low among younger age cohorts, hampering human capital and productivity growth.

Actions taken: University entry requirements based on professional qualifications were harmonised across states (*Länder*) in 2009.

Recommendations: Postpone early tracking and strengthen language support to immigrant students throughout their schooling. Allow all universities greater autonomy to select students and set tuition fees and develop income contingent student loans in those states that have not yet done so.

Reduce tax wedges on labour income and shift taxation to property and consumption taxes

The labour tax wedge remains high, mostly reflecting high social contributions, reducing labour utilisation. More broadly, taxation is skewed towards more distortive labour and capital taxes that harm employment and productivity.

Actions taken: Unemployment insurance contributions were temporarily lowered between 2009 and the beginning of 2011 as a fiscal stimulus measure. Health insurance contributions were also reduced in 2009, but will be increased again in 2011.

Recommendations: Lower social security contributions financed through efficiency gains in the health care system and/or by some shifting of the tax burden towards property and consumption (by phasing out some of the reduced VAT rates).

Other key priorities

Reduce impediments to full-time female labour participation

The average working hours of employed mothers as well as childless married women are significantly below the OECD average, partly due to fiscal disincentives and a lack of childcare facilities.

Actions taken: The government is continuing plans to sharply increase the number of childcare places until 2013.

Recommendations: Reduce the average effective tax rates on labour income of second earners by replacing the joint income assessment of spouses with an individual tax assessment and by introducing health care contributions for non-working spouses.

Ease job protection for regular workers

Protection of regular work contracts remains strict and the gap *vis-à-vis* the lower level of protection for non-regular workers is rising, risking the development of a dual labour market.

Actions taken: No action taken.

Recommendations: Lower the protection of regular work contracts by shortening the period before a dismissal notice can be given and by reforming the regulation of compensation in case of dismissals for economic reasons.

GERMANY

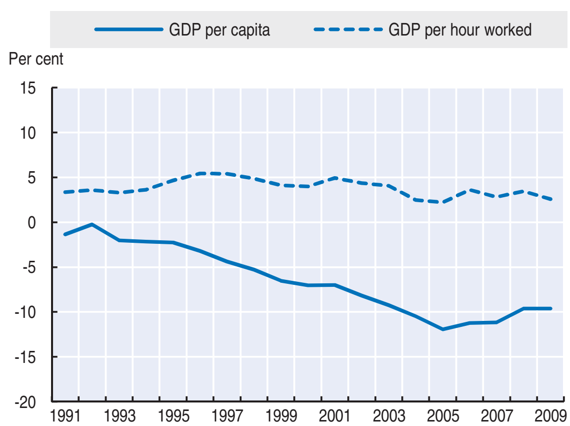
Structural indicators

Average annual trend growth rates, per cent

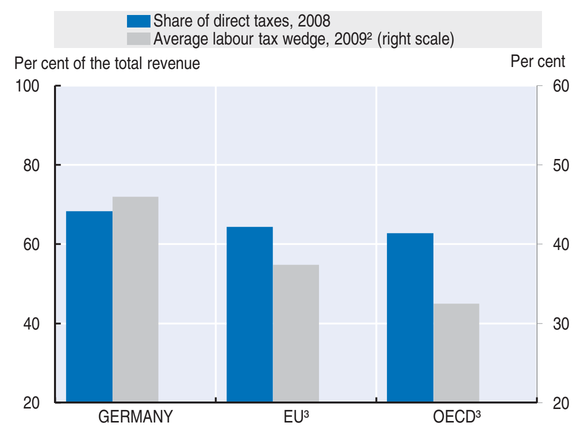
		1999-2009	1999-2004	2004-09
GDP per capita		1.3	1.3	1.4
Labour utilisation		–0.2	–0.4	0.0
of which:	Employment rate	0.3	0.2	0.3
	Average hours	–0.5	–0.6	–0.3
Labour productivity		1.5	1.6	1.4
of which:	Capital intensity	0.7	0.8	0.6
	Multifactor productivity	0.8	0.8	0.8

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

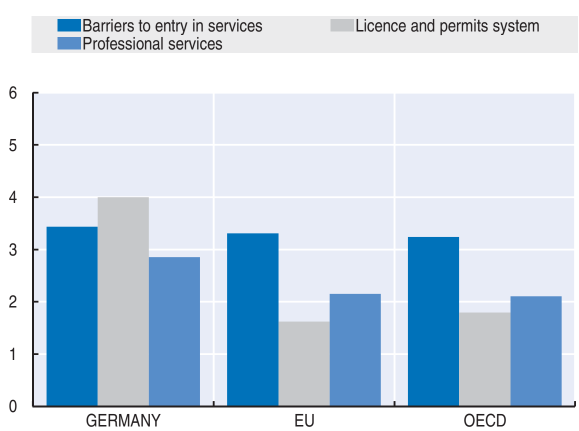
A. The GDP per capita gap is persistent
Gap to the upper half of OECD countries[1]



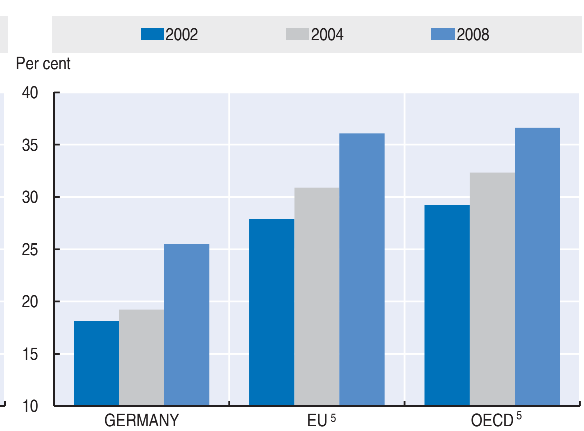
B. Taxation is skewed towards direct taxes



C. Barriers to entrepreneurship remain high, 2008
Index scale of 0-6 from least to most restrictive



D. Tertiary education graduation rates are relatively low[4]



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Single person with low earnings and no child (low earnings refer to two-thirds of average earnings). Percentage of total labour compensation.
3. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.
4. First-time graduation rates for single year of age at tertiary-type A level.
5. Average of European countries in the OECD. EU and OECD averages exclude Belgium, Chile, Estonia, France and Korea.

Source: Chart A: OECD, *National Accounts* and *OECD Outlook* No. 88 *Databases*; Chart B: OECD, *Taxing Wages and Tax Databases*; Chart C: OECD, *Product Market Regulation Database*; Chart D: OECD (2010), *Education at a Glance*.

StatLink http://dx.doi.org/10.1787/888932373856

GREECE

The income gap vis-à-vis *the best performing countries, which had declined in recent years, is likely to increase again as a result of the major ongoing economic crisis. Structural reforms underway in the product and labour markets are vital to reducing the sizeable productivity shortfall and enhancing labour utilisation.*

Priorities supported by indicators

Reduce regulatory barriers to competition

Weak competition in network industries, along with heavy administrative burdens for starting a business and a strict regulation for professional services, reduce competition and hold back productivity performance.

Actions taken: A privatisation programme is underway entailing the sale of stakes in the railway company and the Post. Steps have been taken to liberalise the transport sector. Formalities for starting a business have been simplified.

Recommendations: The ownership stake of the government in key public utilities should be reduced and barriers to entrepreneurship lowered. The announced liberalisation of closed professions should proceed rapidly.

Pursue efforts to reduce the implicit tax on continued work

High financial disincentives to continue working at older ages keep the employment rate among older workers low. "Arduous" occupations represent an important pathway into early retirement.

Actions taken: A recent bill raises the statutory retirement age, raises the penalties for those retiring before 65, and reduces the generosity of pension benefits. The revised list of professions under arduous occupations will be fully implemented from July 2011. Access to minimum pensions has been limited to persons having reached the statutory retirement age. Actuarial studies are being conducted to assess the impact of pension reform.

Recommendations: Proceed with the full implementation of the pension bill. Ensure that parametric changes in the pension system are sufficient for its long-term sustainability.

Reduce the labour tax wedge and broaden the tax base

A high tax wedge on labour and tax exemptions encourage evasion and informal activities.

Actions taken: The recent reform of the tax system aims at broadening its base and cracking down on tax evasion, including through the introduction of presumptive taxation and harsher penalties for tax offenders.

Recommendations: Continue efforts to broaden the tax base and combat tax evasion. Consider reducing tax wedges over the medium term, once fiscal targets are achieved. Such a cut could be financed by cutting public spending, particularly for public administration which absorbs a relatively high share of government outlays.

Other key priorities

Improve the quality of primary and secondary education

Raise the quality of formal education through improvements in teaching quality and school curricula.

Actions taken: Announced reforms aim at improving the quality of the education system through a more comprehensive performance evaluation procedure for teachers.

Recommendations: Redesign school curriculum to improve literacy, numeracy, science and critical thinking skills. Improve the quality of teachers by making the profession more attractive and linking teacher evaluation to effective professional development. Increase the autonomy and accountability of schools.

Ease entry into the labour market

Relatively high minimum costs of labour and strict employment protection legislation affect adversely labour market entry, especially for youth.

Actions taken: A 2010 bill introduces sub-minimum wages to assist those aged 25 or younger to find a job, subsidising their social security contributions. It reduces dismissal costs for larger firms and it provides more flexible rules governing the settlement of severance payments.

Recommendations: Proceed with the full implementation of the new law. Severance costs for white-collar workers should be brought more in line with those incurred for blue-collar workers.

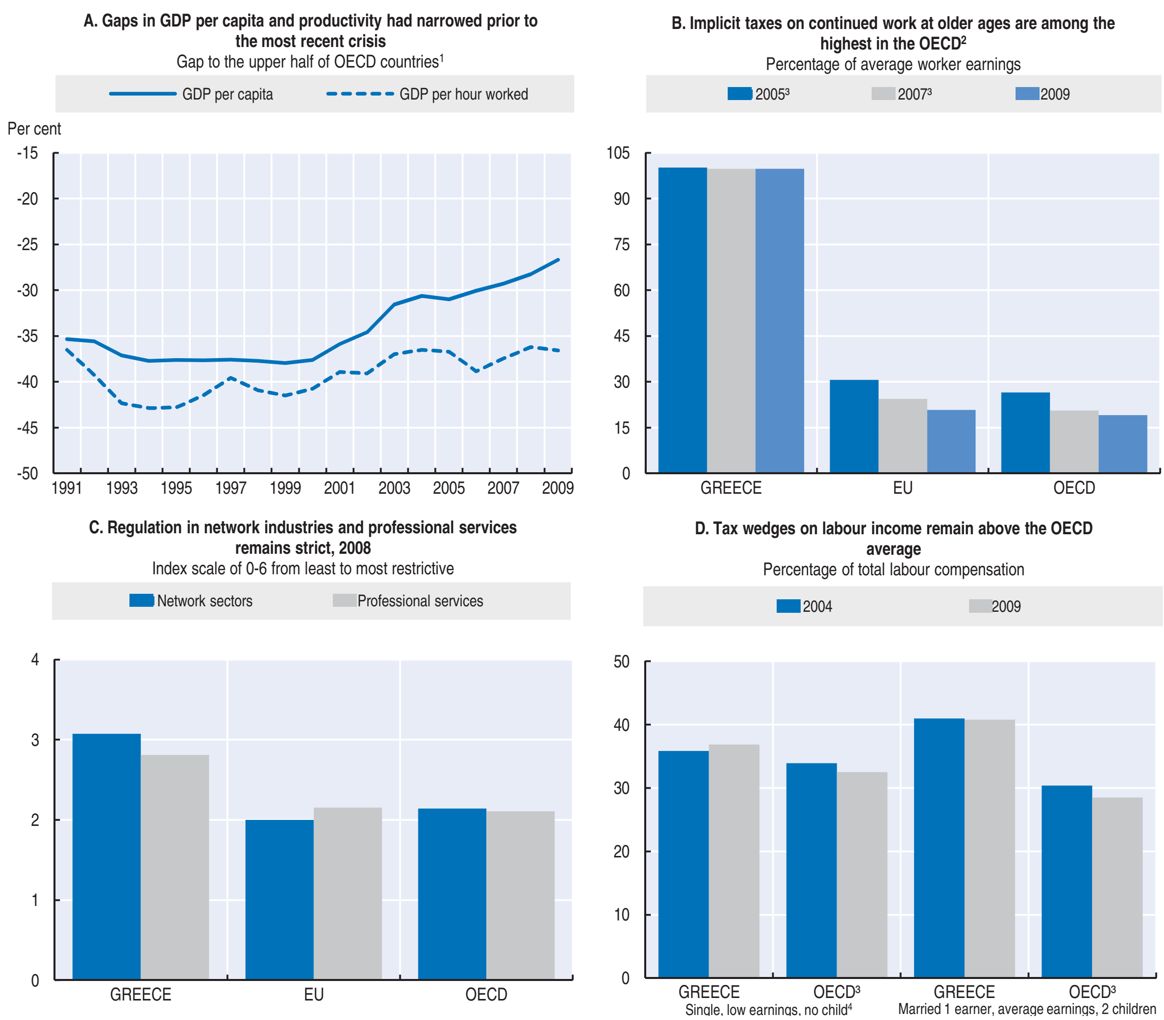
GREECE

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		2.9	3.8	2.0
Labour utilisation		0.9	1.0	0.8
of which:	Employment rate	0.7	0.9	0.5
	Average hours	0.2	0.1	0.3
Labour productivity		2.0	2.8	1.2
of which:	Capital intensity	1.4	1.8	1.1
	Multifactor productivity	0.6	1.0	0.1

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Implicit tax on continued work embedded in the regular old-age pension scheme for 60-year-olds.
3. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.
4. Low earnings refer to two-thirds of average earnings.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: Duval, R. (2003), "The Retirement Effects of Old-Age Pension and Early Retirement Schemes in OECD Countries", *OECD Economics Department Working Papers*, No. 370 and OECD calculations; Chart C: OECD, *Product Market Regulation Database*; Chart D: OECD, *Taxing Wages Database*.

StatLink http://dx.doi.org/10.1787/888932373875

HUNGARY

GDP per capita has converged towards the OECD average but the gap remains substantial because of large shortfalls in labour productivity and, to a lesser extent, labour utilisation. Progress has been made to raise labour supply through reductions in the tax wedge on labour income and incentives to retire early, but more needs to be done in the following areas, notably in order to raise productivity growth.

Priorities supported by indicators

Reduce disincentives to continued work at older ages

Overly-easy access to disability benefits for older workers reduces their employment rates.

Actions taken: The statutory retirement age will be gradually increased to 65 years from 2012. Eligibility conditions for early retirement programmes and disability benefits have been tightened.

Recommendations: Encourage the labour force participation of older workers by further reducing implicit tax rates on continued work and phasing out access to early retirement programmes, including by tightening eligibility for disability benefits through increased focus on remaining abilities and rehabilitation.

Ease business regulations

High administrative and regulatory burdens on businesses and the excess market power of incumbents in network sector limit competition and hampers productivity growth.

Actions taken: Stronger forms of vertical separation and price deregulation have been introduced in the energy sector. The rail freight segment of the national railway company has been privatised.

Recommendations: Simplify entry and exit procedures and relax regulations in retail trade and professional services. Further reduce price controls in network industries. Lift remaining constraints preventing freedom of choice between telecommunication service suppliers.

Reduce the tax wedge on labour income

The average tax wedge on single earners and one-earner households is among the highest in the OECD, encouraging tax evasion and informality and depressing labour utilisation.

Actions taken: In 2009, employer social contributions were cut substantially. Income taxes were lowered in 2009 and 2010. A flat personal income tax rate at 16% and tax credits for families with children will be implemented in 2011.

Recommendations: Further reduce social contributions in a revenue-neutral way so as to maintain a sound fiscal position. Finance recent tax cuts through expenditure restraint, base broadening and higher property taxes rather than through one-off distortive taxes on specific sectors and dismantling of the mandatory funded pension pillar.

Other key priorities

Improve the efficiency of the education system

Early tracking and teachers' inadequate lifelong training undermine the performance of secondary education. Vocational training is not well attuned to the labour market. Higher education financing is inefficient.

Actions taken: The policy to favour practical vocational training in regional centres and in workplaces has continued.

Recommendations: Raise Roma's participation in pre-school education, delay the age at which early tracking takes place and enhance teacher training. Strengthen vocational education by making it more relevant for the labour market. Introduce university tuition charges, continue to develop the current income-contingent loan system, and make the subsidy to under-performing tertiary institutions conditional on rapid improvement.

Increase public sector efficiency

Public administration has not been modernised and service delivery is not cost-efficient. Collaboration between local government authorities is weak.

Actions taken: Cuts have been made to public administration. Laws have been passed to increase the accountability of government agencies and to streamline administrative procedures for firms in the construction sector.

Recommendations: Ensure cost-efficiency of services. Provide more incentives for municipalities to exploit economies of scale. Facilitate the monitoring and evaluation of public administration.

HUNGARY

Structural indicators

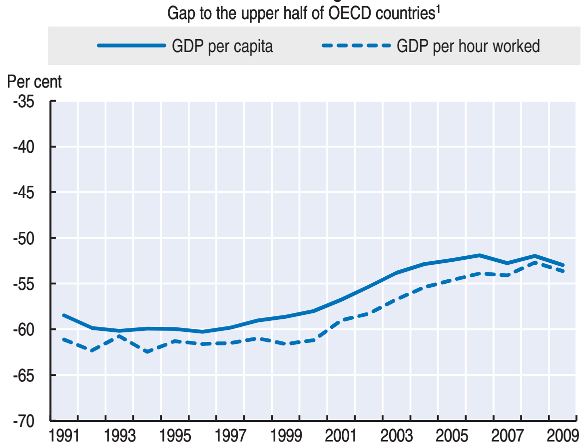
Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		3.3	4.2	2.5
Labour utilisation		0.4	0.7	0.1
of which:	Employment rate	0.6	0.9	0.3
	Average hours	–0.2	–0.2	–0.2
Labour productivity		2.9	3.4	2.3
of which:	Capital intensity	1.8	1.9	1.7
	Multifactor productivity	1.1	1.5	0.6

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

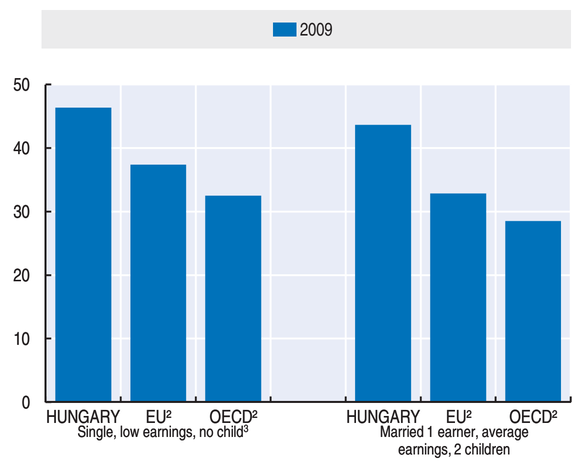
A. Gaps in GDP per capita and productivity remain large

Gap to the upper half of OECD countries[1]



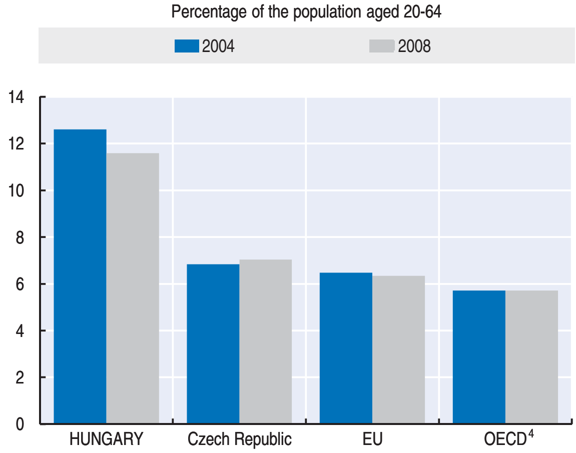
B. The average tax wedge on labour income is high

Percentage of total labour compensation



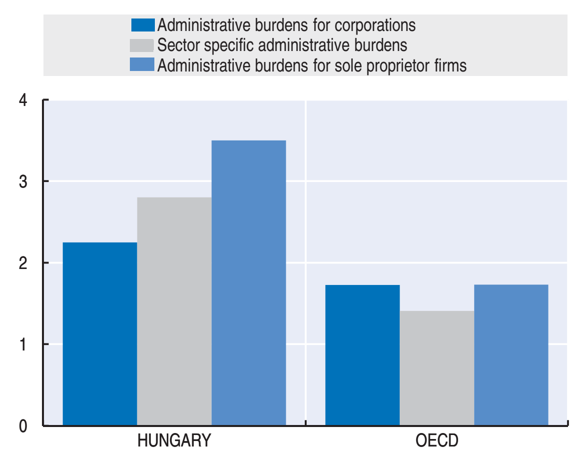
C. A large share of working-age population is receiving disability benefits

Percentage of the population aged 20-64



D. Administrative burdens on start-ups are high, 2008

Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.
3. Low earnings refer to two-thirds of average earnings.
4. Excluding Chile.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *Taxing Wages Database*; Chart C: OECD (2010), *Sickness, Disability and Work: Breaking the Barriers: A Synthesis of Findings across OECD Countries*; Chart D: OECD, *Product Market Regulation Database*.

StatLink http://dx.doi.org/10.1787/888932373894

ICELAND

The shortfall in GDP per capita gap relative to the upper half of OECD countries shrank in the mid-2000s but has since widened as a result of the crisis. This income gap reflects relatively low labour productivity partially offset by one of the highest rates of labour resource utilisation in the OECD. While bank regulation and supervision has been recently reformed, structural reforms in the following areas are needed in order to return to sustained economic growth.

Priorities supported by indicators

Improve education outcomes

School dropout rates are high, international test (PISA) scores in reading and science are below average, and the overall efficiency of the education system is low.

Actions taken: The 2009 secondary education reforms will enable students to complete upper-secondary education more quickly and provide incentives for new and shorter study programmes to counter high dropout rates.

Recommendations: Strengthen school accountability for education outcomes. Adjust curricula to enhance the acquisition of core competences, especially in reading and science. Improve teacher quality in rural areas, where PISA scores are particularly low. Increase effective teaching time and student-teacher ratios to enhance efficiency.

Reduce producer support to agriculture

Agricultural producer support is high, burdening consumers and taxpayers and weighing on productivity.

Actions taken: No action taken.

Recommendations: Reduce agricultural support by lowering tariffs and excise duties, abolishing quotas on agricultural products reducing other forms of producer support and delinking it from production.

Lower entry barriers for domestic and foreign firms

Ownership restrictions inhibit competition in the fisheries and electricity sectors.

Actions taken: No action taken.

Recommendations: Reduce foreign ownership restrictions in the electricity and fisheries sectors. Divest the National Power Company's generation activities, which benefit from a cost-of-capital advantage conferred by government ownership, to create a competitive market in electricity generation.

Other key priorities

Increase public sector efficiency

Decisions on resource use and programme management are weakened by inadequate performance information.

Actions taken: No action taken.

Recommendations: Introduce performance-based budgeting with key performance indicators and integration of evaluations of progress towards meeting performance objectives. Strengthen conflict of interest disclosure.

Reduce barriers to product market competition

Regulatory and administrative opacity inhibit competition across the domestic economy. Competition is also restricted by legal barriers to entry in the energy, telecommunications and transport sectors.

Actions taken: No action taken.

Recommendations: Review and reduce the number of licences and permits required and use plain language in regulations. Reduce entry barriers in the electricity, telecommunications, road-freight transport, air-transport, and airport and seaport sectors.

ICELAND

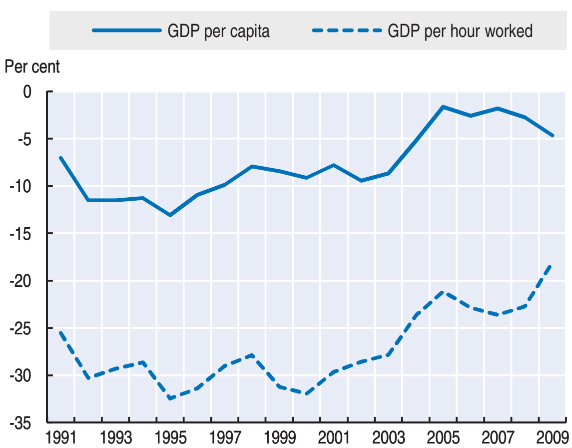
Structural indicators

Average annual trend growth rates, per cent

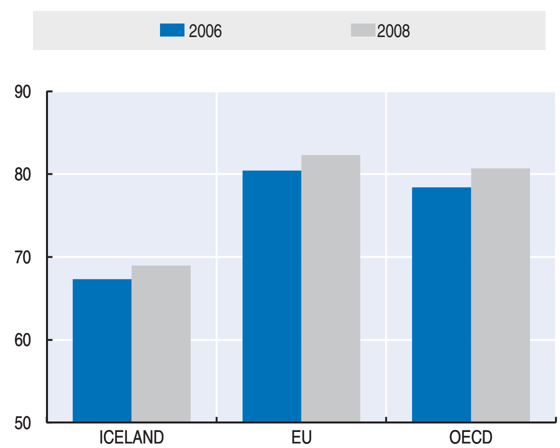
		1999-2009	1999-2004	2004-09
GDP per capita		2.2	2.7	1.8
Labour utilisation		–0.1	0.0	–0.1
of which:	Employment rate	0.2	0.2	0.2
	Average hours	–0.3	–0.3	–0.3
Labour productivity		2.3	2.7	1.9
of which:	Capital intensity	0.6	0.3	0.8
	Multifactor productivity	1.7	2.4	1.1

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

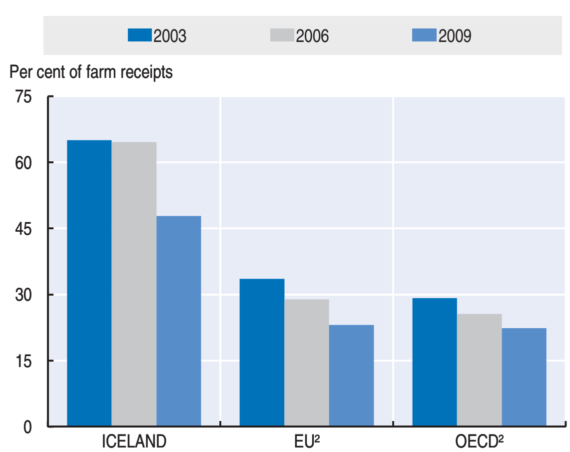
A. The gap in GDP per capita has slightly widened recently
Gap to the upper half of OECD countries[1]



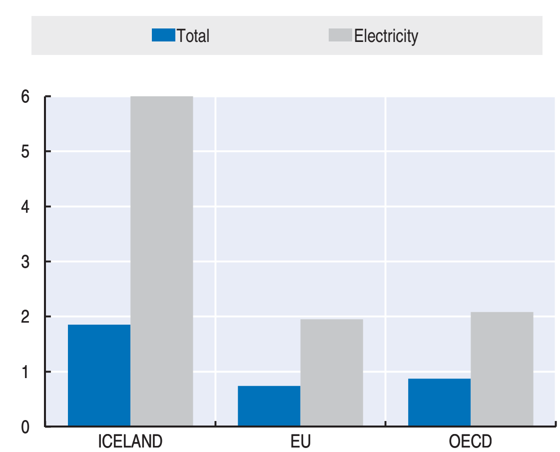
B. Upper secondary educational attainment is relatively poor
Percentage of the population aged 25-34



C. Agricultural support has declined but is still very high



D. Barriers to FDI are high, particularly in electricity, 2006[3]
Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.
3. The FDI regulation index looks only at statutory restrictions and does not assess the manner in which they are implemented.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD (2010), *Education at a Glance*; Chart C: OECD, *Producer and Consumer Support Estimates Database*; Chart D: Koyama, T. and S. S. Golub (2006), "OECD's FDI Regulatory Restrictiveness Index: Revision and Extension to More Economies", OECD *Economics Department Working Papers*, No. 525.

StatLink http://dx.doi.org/10.1787/888932373913

INDIA

India continues to achieve one of the highest rates of GDP per capita growth in the world. Nevertheless, the income gap with OECD countries remains large, primarily reflecting low levels of labour productivity, calling for further reforms to support rapid and inclusive growth. Incremental reforms of administrative regulation introduced by governments at all levels have led to some improvement in the operating environment for business. However, more fundamental reforms are needed in the following areas.

Priorities supported by indicators

Reduce trade and FDI barriers as well as administrative burdens

Trade and FDI restrictions, along with administrative red tape, still hinder investment and productivity.

Actions taken: Thresholds for FDI applications requiring the consent of the central government cabinet have been raised and existing FDI regulations consolidated to improve transparency.

Recommendations: High FDI barriers in retail and other service sectors should be reduced. Trade protection should be reduced across the board, with a first priority on the most heavily protected sectors. The use of ICT should be expanded to improve government service delivery and transparency.

Improve education outcomes

Low graduation rates and relatively poor education quality hamper human capital formation.

Actions taken: The 2009 Right to Free Education Act stipulates that every child aged between 6 and 14 years has the right to free and compulsory education.

Recommendations: Consider opportunities to decentralise elements of school management and teacher recruitment to either the local government or school level. Strengthen school principal and teacher accountability and improve the quality of, and access to pre and in-service teacher training. Allow greater university autonomy and reduce barriers to entry in the university sector, including by relaxing entry of foreign education providers.

Ease job protection

Rigid employment protection legislation undermines employment and productivity growth in the formal sector.

Actions taken: No action taken.

Recommendations: Reform employment protection measures that discriminate against large firms and remove the most restrictive provisions concerning the need for prior government authorisation to terminate employment. Streamline central and state government legislation to reduce uncertainty and complexity.

Other key priorities

Enhance infrastructure provision

Low provision and weak quality of infrastructure damages the business operating environment and hurts productivity.

Actions taken: Spending on key infrastructure has risen sharply. The central government initiated the National Land Records Modernisation Programme to consolidate and modernise land record systems, which will provide greater certainty to investors in infrastructure projects and help expedite project applications.

Recommendations: Reduce regulatory uncertainty in infrastructure sectors across states to enhance opportunities for private sector participation. Eliminate cross-subsidies in electricity and rail sectors. Streamline land acquisition procedures to reduce development costs and delays.

Undertake wide-ranging financial sector reforms

The level of development of the financial sector is insufficient to meet the needs of a rapidly developing economy.

Actions taken: The government has announced the formation of a Financial Stability and Development Council to monitor macro prudential supervision of the economy and address inter-regulatory coordination issues.

Recommendations: Allow greater participation by foreign investors in the financial services sector and issue more bank licenses to expand the coverage of banking services. Proceed with plans to establish a new independent debt management office.

INDIA

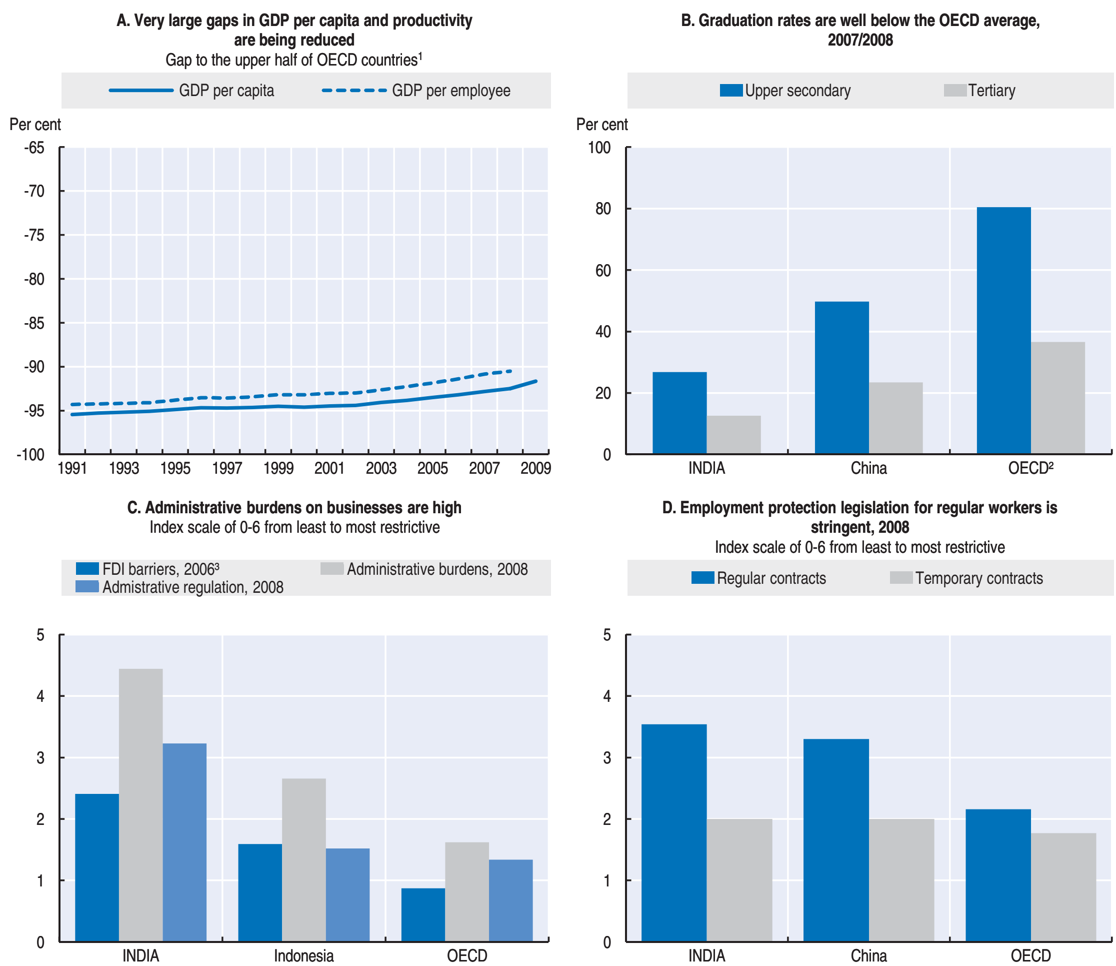
Structural indicators

Average annual trend growth rates, per cent

		1998-2008	1998-2003	2003-08
GDP per capita		5.4	4.1	6.9
Labour utilisation		..	..	..
of which:	Employment rate	0.4	0.4	0.5
	Average hours	..	..	..
Labour productivity[1]		5.0	3.7	6.4
of which:	Capital intensity	..	..	..
	Multifactor productivity	..	..	..

1. Labour productivity is measured as GDP per employee.

Source: Estimates based on World Bank (2010), *World Development Indicators (WDI)* and ILO (2010), *Key Indicators of the Labour Market (KILM) Databases*.



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per employee (in constant 2005 PPPs).
2. For upper secondary education, average of OECD countries excluding Australia, Austria, Belgium, Estonia, France and the Netherlands; for tertiary education, excluding Belgium, Chile, Estonia, France and Korea.
3. The FDI regulation index looks only at statutory restrictions and does not assess the manner in which they are implemented.

Source: Chart A: World Bank (2010), *World Development Indicators (WDI) and ILO (2010), Key Indicators of the Labour Market (KILM) Databases*; Chart B: OECD (2010), *Education at a Glance*; *India National Sample Survey* (2007/8) and *China Statistical Yearbook*; Chart C: Koyama, T. and S. S. Golub (2006), "OECD's FDI Regulatory Restrictiveness Index: Revision and Extension to More Economies", *OECD Economics Department Working Papers*, No. 525, OECD, *Product Market Regulation Database* and Woelf, A. *et al.* (2010), "Product Market Regulation Extending the analysis beyond OECD countries", *OECD Economics Department Working Papers*, No. 799; Chart D: OECD, *Employment Database*.

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INDONESIA

Per capita incomes are converging towards OECD levels, but the gap remains very large mainly owing to a labour productivity shortfall. Further actions in the areas below would help to reduce this gap. In other areas, efforts have been made recently in climate-change mitigation policies by committing to greenhouse gas emission-reduction targets.

Priorities supported by indicators

Strengthen resources for secondary education and improve the overall efficiency of the education system

Public spending has risen markedly especially for primary education but is still relatively low at higher levels of education. Teaching quality is low especially in rural areas, harming attainment.

Actions taken: The Ministry of Education launched a 2005-09 strategy aimed at improving the governance, access to, and quality of education.

Recommendations: Make income transfer programmes conditional on children attending secondary school and finance the secondary school enrolment fee for disadvantaged children in order to boost enrolment rates. To improve teaching quality, regularly assess teachers' pedagogical skills.

Improve the regulatory environment for infrastructure

Regulatory authorities lack independence and pervasive regulatory uncertainties hinder private investment.

Actions taken: A 2009 electricity law paves the way to increased private participation in generation, distribution and transmission. The government has announced it would finance only 36% of a USD 157 billion investment plan from 2010 to 2014, with the private sector expected to fill the financing gap.

Recommendations: Reduce regulatory barriers and uncertainties to entice private investment. Grant independence to regulatory bodies, strengthen their public accountability, and establish new ones in sectors lacking them. Reform land expropriation procedures to shorten the time needed to reach fair compensation decisions.

Reform labour regulation to address the problem of informality

The rigid labour code provides strong protection to employees in the formal sector, thereby encouraging informal job creation and undermining labour productivity.

Actions taken: No action taken.

Recommendations: In order to make the insurance system against wage income loss more effective, introduce some form of unemployment benefits while simplifying dismissal procedures and reducing severance payments. In addition, cap real increases in the minimum wage to ensure they do not to exceed labour-productivity gains.

Other key priorities

Ease barriers to entrepreneurship and strengthen institutions to fight corruption

Despite some progress, the business environment continues to be less attractive than in regional peers. Excessive administrative burdens, high FDI restrictions in some sectors and corruption limit entrepreneurship.

Actions taken: In 2010, the government lowered FDI restrictions, especially in services. The 2009 law on local taxes limits the types of levies local governments can charge and promotes tax competition.

Recommendations: Simplify administrative procedures for establishing new firms by reducing the number of business licenses and setting up one-stop shops in districts where these are currently lacking. Reduce further FDI restrictions in telecommunications and transport. Continue efforts to fight corruption by reforming the tax office and further simplifying business licensing.

Phase out energy subsidies

Energy subsidies are economically costly, socially inequitable, environmentally damaging and inconsistent with the government's green strategy.

Actions taken: The 2010 Medium Term Development Plan states that fossil-fuel subsidies will be eliminated by 2014. The government has increased support to renewable forms of energy.

Recommendations: Stick to the planned timetable to eliminate fossil-fuel subsidies and extend the commitment to electricity subsidies, while offering more effective targeted income support to the poor and those households that are most adversely affected.

INDONESIA

Structural indicators

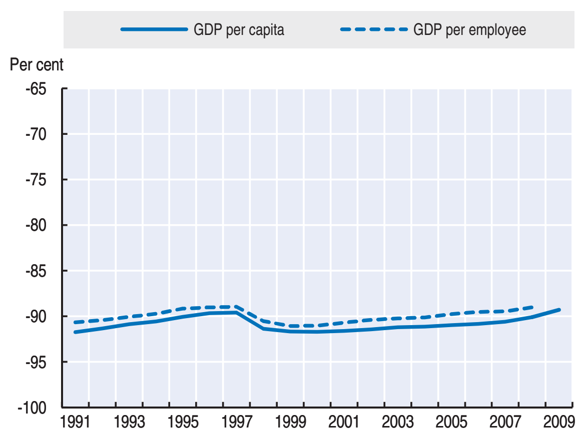
Average annual trend growth rates, per cent

		1998-2008	1998-2003	2003-08
GDP per capita		3.4	2.3	4.4
Labour utilisation		. .	. .	. .
of which:	Employment rate	0.6	0.4	0.9
	Average hours	..	. .	. .
Labour productivity[1]		2.7	2.0	3.5
of which:	Capital intensity	. .	. .	
	Multifactor productivity	. .	. .	. .

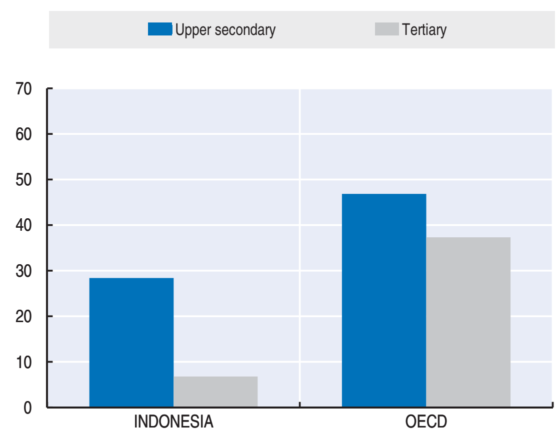
1. Labour productivity is measured as GDP per employee.

Source: Estimates based on World Bank (2010), *World Development Indicators (WDI)* and ILO (2010), *Key Indicators of the Labour Market (KILM) Databases*.

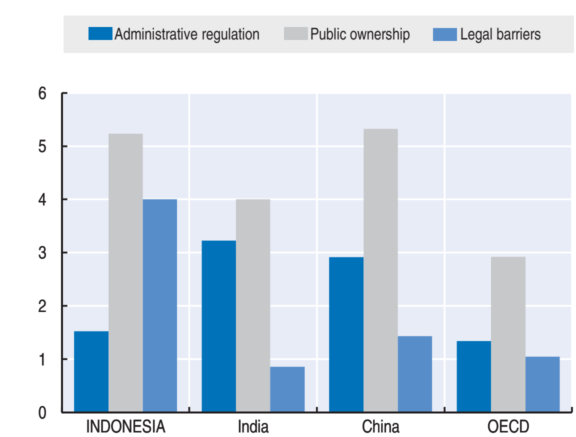
A. Gaps in GDP per capita and productivity remain very large
Gap to the upper half of OECD countries[1]



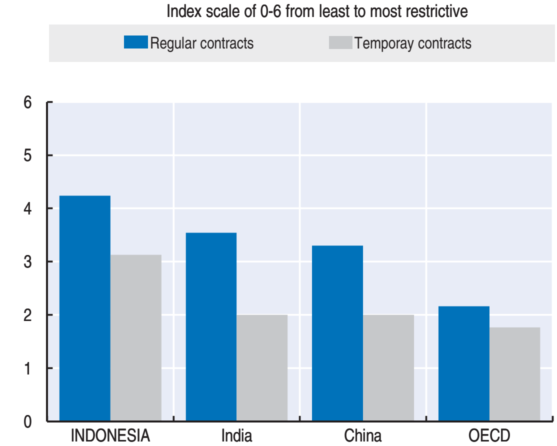
B. Secondary and tertiary education graduation rates are low, 2008[2]



C. Product market regulation is stringent, 2008
Index scale of 0-6 from least to most restrictive



D. Employment protection legislation is strict especially for regular contracts, 2008
Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per employee (in constant 2005 PPPs).
2. Graduation rates for single year of age. Upper secondary graduation rates refer to general programmes. Tertiary graduation rates refer to first degree graduation at tertiary-type A level.

Source: Chart A: World Bank (2010), *World Development Indicators (WDI)* and ILO (2010), *Key Indicators of the Labour Market (KILM) Databases*; Chart B: OECD (2010), *Education at a Glance*; Chart C: OECD, *Product Market Regulation Database* and Woelf, A. *et al.* (2010), "Product Market Regulation Extending the analysis beyond OECD coutries", *OECD Economics Department Working Papers*, No. 799. Chart D: OECD, *Employment Database*; Chart D: OECD, *Employment Database*.

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IRELAND

Ireland has experienced a severe set-back in living standards. Unemployment has risen steeply and labour force participation declined, resulting in a labour utilisation gap relative to the upper half of OECD countries. While the government is launching reforms aimed at improving macroprudential regulation, efforts in the areas below should be pursued to raise long-term growth prospects and avoid a structural deterioration in the labour market.

Strengthen work incentives for women

Women participation rates are well below those of best-performing OECD economies, especially for mothers. High childcare costs and limited supply are major obstacles to participation.

Actions taken: The government abolished the Early Childcare Supplement which is being replaced in 2010 by a new pre-school Early Childhood and Education Scheme for those aged 3½ to 4½.

Recommendations: Consider measures to link childcare support to employment status. Prioritise access to community childcare to working parents, especially lone parents. In the longer term and as fiscal circumstances allow, increase the supply of childcare further while maintaining quality.

Strengthen competition in non-manufacturing sectors

Competition in utilities and some sheltered service sectors remains relatively weak, harming productivity.

Actions taken: Work is ongoing to build a second North-South and an East-West electricity interconnector. The electricity regulator announced in 2010 that it would end price regulation in the domestic retail market.

Recommendations: Increase competition in the electricity and gas markets. Continue to integrate the electricity market with the UK market. Increase competition in retail by allowing bigger stores. Replace the 20% pharmacy retail mark-up with a flat dispensing fee and auction the right to run a pharmacy. Remove unnecessary restrictions in the legal profession.

Improve the effectiveness of publicly-funded R&D

R&D spending remains relatively low and most activity is undertaken by foreign firms.

Actions taken: The government created from May 2010 a new Department of Enterprise, Trade and Innovation aimed at enhancing the delivery of the R&D agenda, with a focus on stronger commercial outputs and the efficiency of expenditure.

Recommendations: Evaluate the existing tax incentive, and channel more support through it if it has been successful. Strengthen the links between universities and industry, for example by promoting the commercialisation of inventions and rationalising business incubators into a small number of high-quality specialist units.

Other key priorities

Enhance activation policies

Implementation of conditionality under activation measures is relatively weak, harming their effectiveness and thereby labour utilisation. There are too many agencies involved in providing assistance to the unemployed.

Actions taken: In 2009 the government expanded the training-and-work experience activation places targeted at vulnerable groups. The government announced 15000 additional places in the 2011 Budget, and its intention to streamline Public Employment Services (PES) in the 2011-14 National Recovery Plan (NRP).

Recommendations: Tighten activation requirements for the unemployed. All unemployment-benefit claimants should be subject to early and regular interaction with PES, where counsellors should follow up on job referrals and participation in labour market programmes. Unify the administration of unemployment-related policies in a single government body. Cost-effective programmes targeted at the needs of those without jobs should be expanded and additional administrative resources allocated to activation policies.

Further improve infrastructure

Infrastructure quantity and quality remain relatively low and the use of pricing mechanisms is not widespread.

Actions taken: The government announced in the 2011-14 NRP its intention to introduce water metering for homes. Water charges will be based on consumption above a free allocation.

Recommendations: Allow for better use of infrastructure services through appropriate user charges. Charge the full cost of providing drinking water and collecting and treating sewage. Consider introducing congestion charges.

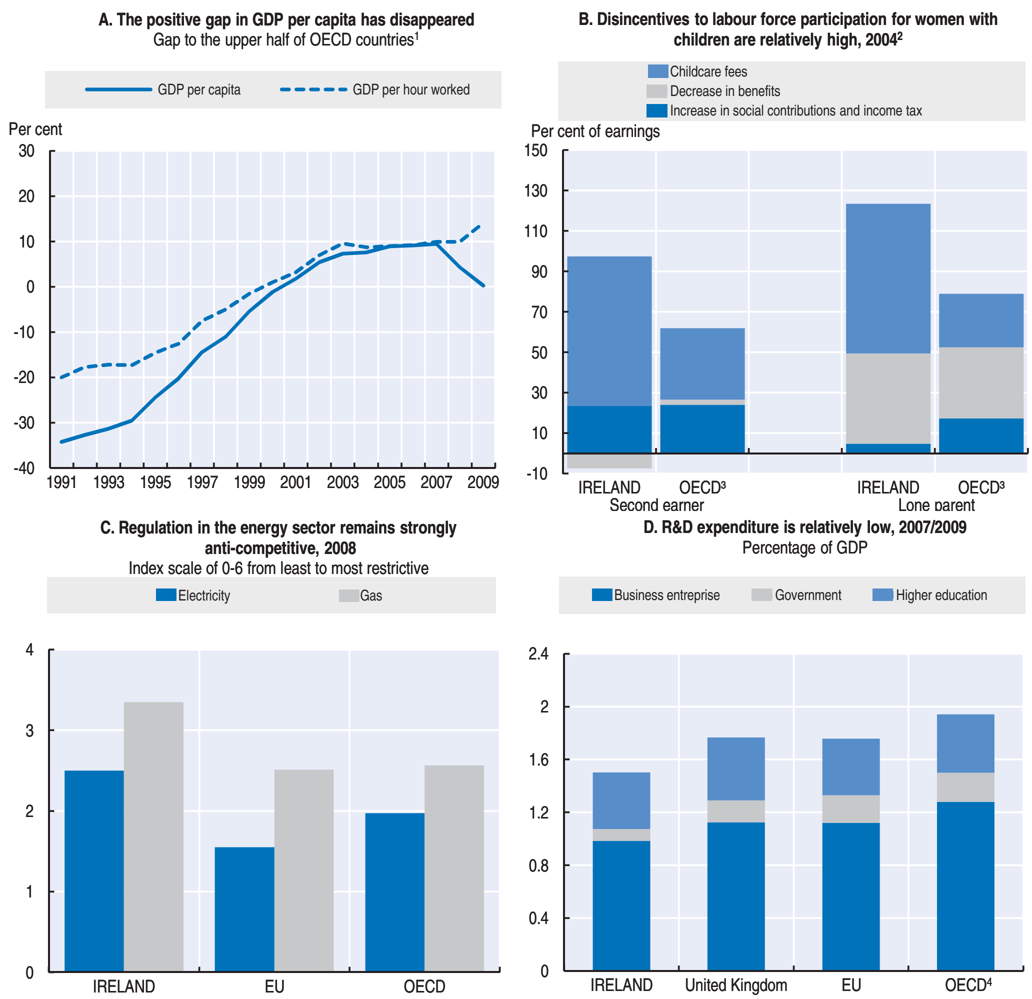
IRELAND

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		3.0	4.8	1.3
Labour utilisation		–0.1	0.8	–0.9
of which:	Employment rate	0.9	2.0	–0.2
	Average hours	–1.0	–1.2	–0.8
Labour productivity		3.1	4.0	2.2
of which:	Capital intensity	1.5	1.5	1.4
	Multifactor productivity	1.7	2.6	0.8

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Based on implicit tax on returning to work, defined as the cost of childcare, reductions in income-related benefits and increases in social contributions and personal income taxes, all relative to earnings in the new job. Measured for second earners and for lone parent with income equal to two-thirds of average earnings.
3. Average of OECD countries excluding Chile, Estonia, Israel and Slovenia.
4. Average of OECD countries excluding Chile.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD (2004), *Benefits and Wages: OECD Indicators*; Chart C: OECD, *Product Market Regulation Database*; Chart D: OECD, *Main Science and Technology Indicators Database.*

StatLink http://dx.doi.org/10.1787/888932373970

ISRAEL

GDP per capita has moved towards the upper half of the OECD distribution since the mid-2000s but a major gap remains, reflecting a shortfall in productivity. Notable attention has been paid recently to transport infrastructure and concentration in the financial sector. However, further structural reforms are needed in the following areas.

Priorities supported by indicators

Improve education outcomes

Outcomes in state education are weak, and especially so among Arab students. In the independent Ultra-orthodox schools religious study takes precedence over core learning.

Actions taken: A reform in lower-secondary education (New Horizon), which increases teachers' pay while introducing more small-group teaching was extended to all schools in the 2009/10 school year. Other ongoing reforms include extension of compulsory education, reduction of class sizes, changes to final examinations and modifications to school-funding formulae.

Recommendations: Introduce a New Horizon type reform in upper-secondary schools. Strengthen targeted support for Arab Israeli students. Expand and properly enforce curriculum requirements for state funding for Ultra-orthodox schools. In tertiary education, pursue tuition-fee and other reforms along the lines outlined by the Shochat Committee.

Cut red tape for businesses

The administrative process for setting up and running a business is burdensome, limiting firm entry and productivity.

Actions taken: The authorities have partially liberalised land ownership and reformed land administration (the Land Reform Bill, 2009). First steps towards a one-stop-shop system for small and medium enterprises were taken in 2010.

Recommendations: Follow through on plans to ease building regulations, and continue efforts to streamline the number of and processing times for business licences.

Complete network industry reform

Substantial unfinished business remains in some network sectors, notably the electricity sector, hampering competition and productivity.

Actions taken: In port services, initial public offerings for the two operating companies and changes to service fee regulations were made in 2010. In telecoms, a schedule of cuts in the mobile phone connectivity fee has begun. In electricity generation, a payment guarantee to encourage private providers has been introduced.

Recommendations: Resolve the reform deadlock in the electricity sector, continue reforms in telecoms (notably establish an independent telecommunications regulator), and make further progress in introducing competition in post, rail and water services.

Other key priorities

Restructure taxation away from direct taxes

The top rates of personal income tax are relatively high, and the corporate rate remains above the norm for comparable economies.

Actions taken: The schedule of income tax cuts was tempered in 2009. In 2010, a temporary hike in VAT was extended and there are proposals for increases in other indirect taxes.

Recommendations: Pursue feasible avenues for raising indirect taxes, and remain open to further tempering of income-tax cuts.

Encourage labour supply among low-income households

Employment rates and skill levels among certain groups are low, notably in the rapidly growing Arab and Ultra-orthodox communities, and contribute to high rates of relative poverty. The lack of progress in overcoming these socio-economic problems is related to failure to fully develop welfare-to-work programmes, a relatively high minimum wage and weaknesses in labour regulation.

Actions taken: Policies took a backwards step in 2010 with the abandonment of a promising private-sector job-placement scheme (the Wisconsin Programme), which had been operating in several areas of the country since 2005.

Recommendations: Re-introduce a placement scheme, increase the coverage and value of the earned-income tax credit, and combine better enforcement of labour regulation with reduction in the value of the minimum wage relative to average earnings.

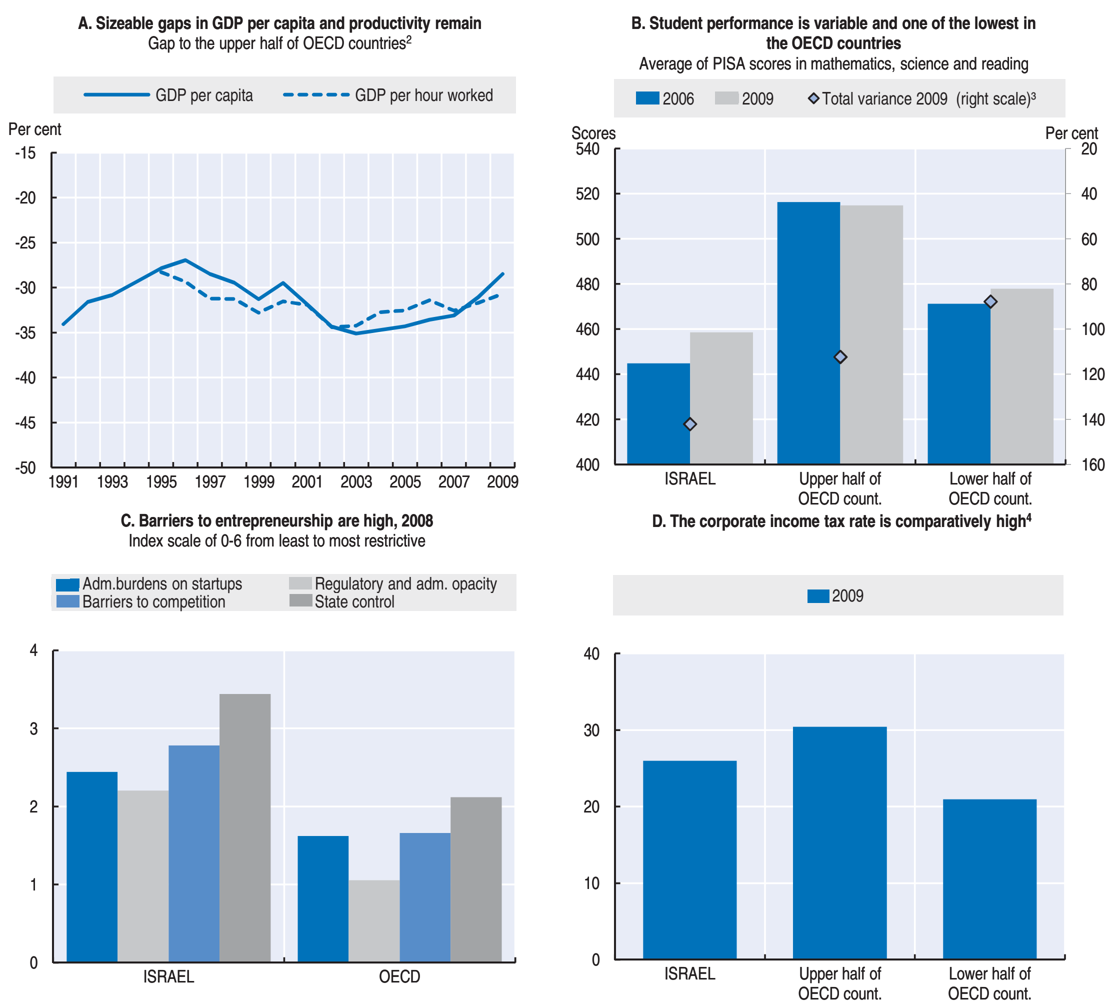
ISRAEL[1]

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		1.6	1.3	1.8
Labour utilisation		0.1	–0.1	0.4
of which:	Employment rate	0.5	0.3	0.7
	Average hours	–0.3	–0.4	–0.3
Labour productivity		1.4	1.4	1.4
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. 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.
2. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
3. The variance components, in reading performance only, were estimated for all students in participating countries with data on socio-economic background and study programmes. The variance is calculated, as a percentage of the average OECD variance, from the square of the standard deviation for the students used in the analysis.
4. Combined central and sub-central (statutory) corporate income tax rate.

Source: Chart A: OECD, *National Accounts and OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *PISA 2009 Database*; Chart C: OECD, *Product Market Regulation Database*; Chart D: World Bank, *World Development Indicators.*

StatLink http://dx.doi.org/10.1787/888932373989

ITALY

GDP per capita and productivity have continued to decline relative to the upper half of OECD countries. Moves to improve the efficiency of public administration through results-oriented management and simplification of legislation have continued though significant impacts cannot yet be seen. Further reforms are needed in the areas below.

Priorities supported by indicators

Reduce regulatory and administrative barriers to competition

Productivity growth is still hampered by restrictions on competition through excessive regulation, notably in professional services. Inefficiencies in public administration also add to costs in the private sector.

Actions taken: Some backward action occurred in 2009 through less-than-full implementation of 2006 legislation on professional services.

Recommendations: Fully implement and extend the 2006 "Bersani" decree, removing anti-competitive regulations and structuring public interest regulations to minimise anti-competitive effects and limit barriers to entry. Pursue the stalled programme of promoting one-stop shops, and more fully streamline administrative processes.

Improve the efficiency of secondary and tertiary education

Educational outcomes, measured by international student test (PISA) scores, are poor considering the level of expenditure. The number of university graduates remains relatively low, especially with research degrees.

Actions taken: Policies announced in 2009 aim to improve cost-efficiency but action so far concentrated on broader funding cuts.

Recommendations: Put resources into evaluation so as to provide reliable feedback to schools and universities. Ensure that Vocational Educational Training (VET) programmes put sufficient emphasis on general skills. Ensure that recruitment systems employ suitably qualified teachers and researchers. Increase university autonomy to set tuition fees, supporting students through income-contingent-repayment loans and means-tested grants.

Improve the efficiency of the tax structure

A high tax wedge on labour and a relatively high corporate tax rate (with many exemptions) distort incentives to the supply of labour and capital. Low tax compliance damages revenues for any given statutory rates.

Actions taken: Reductions in 2009 in income taxes on overtime or productivity pay seem to have done little to reduce the overall tax wedge on labour. A partial amnesty in 2009 and 2010 for funds held abroad raised one-off revenue but gave ambiguous incentives for tax compliance.

Recommendations: Reduce marginal rates on labour and capital and shift the weight of taxation towards property and consumption. Compliance could be improved by simplification of tax law and elimination of many tax expenditures, as well as by better enforcement.

Other key priorities

Reduce public ownership

High public ownership in some sectors reduces competition. Consumer interests are not always the priority in competition policy. TV media remain dominated by state companies and one private company.

Actions taken: Alitalia was privatised in 2008-09, no action taken since.

Recommendations: Privatise more aggressively, reasserting the priority of consumer interests. Ask the Competition Authority to assess the degree of competition in TV media.

Reduce labour market dualism

Strong labour market segmentation exists between the public sector, private sector workers on permanent contracts, those on temporary contracts, and the informal sector.

Actions taken: No action taken.

Recommendations: Relax job protection on standard contracts to increase incentives to hire permanent rather than temporary workers. Allow some regional variation of public sector wages in line with variations in the cost of living.

ITALY

Structural indicators

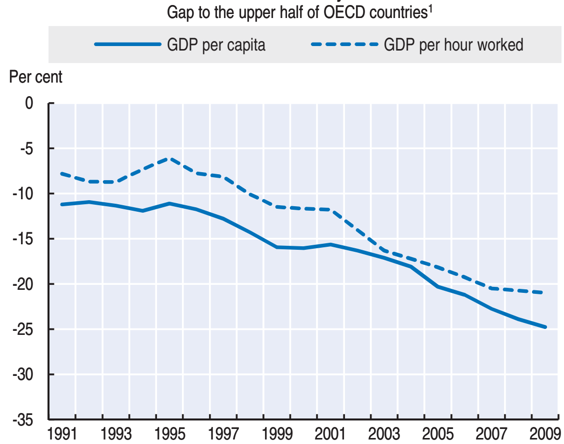
Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		0.5	1.2	–0.2
Labour utilisation		0.2	0.6	–0.3
of which:	Employment rate	0.4	0.9	0.0
	Average hours	–0.3	–0.3	–0.3
Labour productivity		0.3	0.6	0.1
of which:	Capital intensity	0.7	0.9	0.6
	Multifactor productivity	–0.4	–0.3	–0.5

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

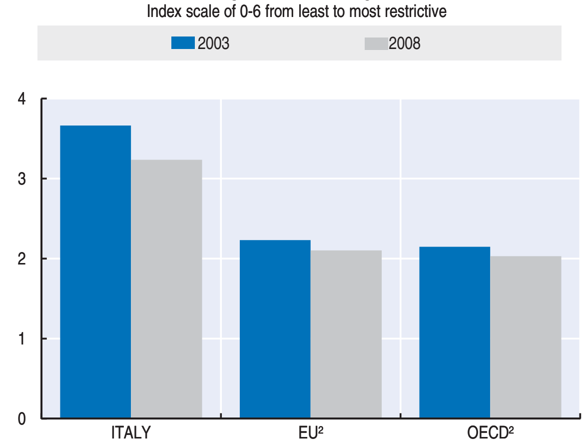
A. Gaps in GDP per capita and productivity have widened substantially

Gap to the upper half of OECD countries[1]

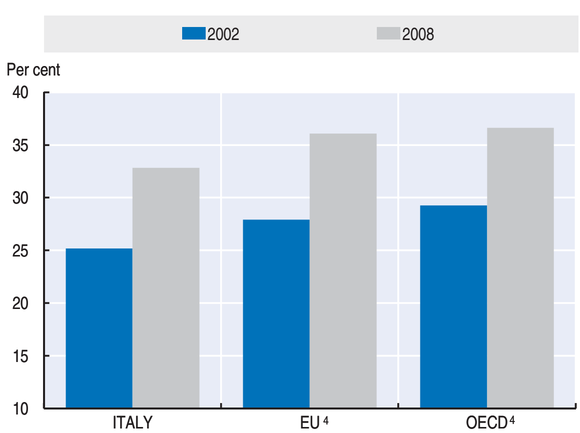


B. Despite some progress, professional services regulation remains high

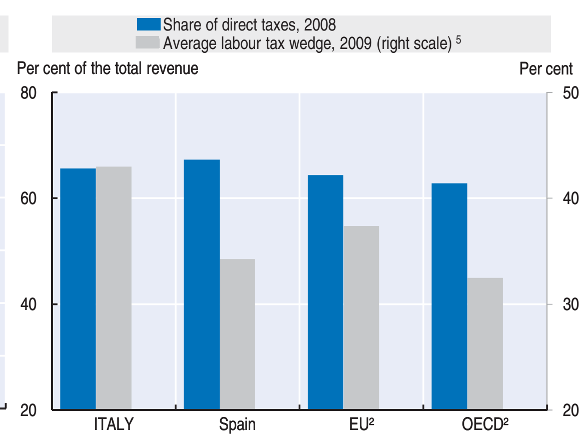
Index scale of 0-6 from least to most restrictive



C. Tertiary education graduation rates have improved but remain low[3]



D. The average tax wedge on labour income is high and the structure of taxation weakly efficient



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.
3. First-time graduation rates for single year of age at tertiary-type A level.
4. Average of European countries in the OECD. EU and OECD averages exclude Belgium, Chile, Estonia, France and Korea.
5. Single person with low earnings and no child (low earnings refer to two-thirds of average earnings). Percentage of total labour compensation.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *Product Market Regulation Database*; Chart C: OECD (2010), *Education at a Glance*; Chart D: OECD, *Taxing Wages and Tax Databases*.

StatLink http://dx.doi.org/10.1787/888932374008

JAPAN

The income gap relative to the upper half of OECD countries has been persistent over the last decade, reflecting a large productivity shortfall. The government has announced a Growth Strategy aimed at boosting incomes, notably in the environment, health care and tourism sectors, but it needs also to focus more on the following regulatory reforms to boost demand and productivity growth.

Priorities supported by indicators

Reform regulation in network sectors

Regulation of network sectors is more stringent than in the average OECD country, thus limiting competition and hindering productivity.

Actions taken: The privatisation process of Japan Post Bank and Japan Post Insurance, which were to be completed by 2017, has been stopped. The government proposed revising the Broadcast Act to integrate broadcasting services and communications.

Recommendations: Enhance efficiency in the network sectors – particularly electricity – through further deregulation and privatisation, while strengthening competition policy. The privatisation of Japan Post should be carried out as outlined in the 2005 law in order to encourage the flow of funds towards more productive private-sector investments.

Reduce producer support to agriculture

Support for agricultural producers is still double the OECD average, distorting trade and production, while boosting consumer prices of agricultural products far above world prices.

Actions taken: The government implemented a direct income support programme for targeted cereals, including rice, on a trial basis in 2010.

Recommendations: Further scale back the level of support to agriculture. Shift its composition away from support based on output and towards direct support for farmers to reduce the distortion of trade and production decisions.

Reduce the dualism of job protection

The large share of non-regular workers, at more than one-third of total employment, discourages on-the-job training, while creating equity concerns due to inequality in pay and coverage by the social security system.

Actions taken: The government revised the Employment Insurance Act to relax the conditions for receiving benefits in 2009 and expanded the number of workers covered by the insurance in 2010.

Recommendations: Reduce employment protection for regular workers, while expanding social insurance coverage for non-regular workers to equalise social costs of employment among different types of contracts.

Other key priorities

Lower restrictions on FDI

The low stock of inward FDI – the smallest in the OECD area at 4% of GDP – limits competition, especially in services.

Actions taken: The government decided to establish a special zone system to revitalise local economies, including by attracting foreign firms. In 2010, it announced a programme to facilitate inward FDI to make Japan a hub in Asia.

Recommendations: Promote inward FDI by reducing legal and non-legal impediments, especially in services, and nurture an attractive business environment to attract foreign investors through tax and labour market reforms.

Improve the efficiency of the tax system

Reduce corporate taxes and improve the efficiency of the tax system. With the highest corporate tax rate among OECD countries and the lowest consumption tax rate, tax structure in Japan undermines productivity.

Actions taken: The government decided in 2010, in principle, to reduce the effective corporate tax rate to the average of major countries and to review tax expenditures to expand the tax base.

Recommendations: Implement the planned reform of the corporate tax, while increasing the consumption tax and property-holding taxes to raise the necessary revenues to finance growing welfare spending and to improve the fiscal balance.

JAPAN

Structural indicators

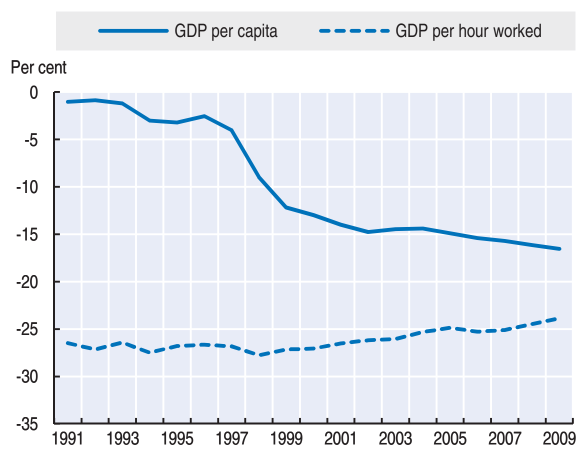
Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		0.9	1.0	0.8
Labour utilisation		–0.8	–0.9	–0.8
of which:	Employment rate	–0.4	–0.3	–0.4
	Average hours	–0.4	–0.6	–0.3
Labour productivity		1.7	1.8	1.6
of which:	Capital intensity	0.6	0.8	0.4
	Multifactor productivity	1.1	1.1	1.1

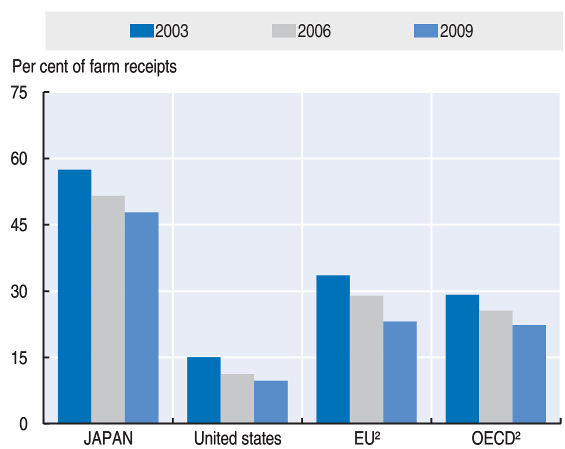
Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

A. The gap in GDP per capita persists

Gap to the upper half of OECD countries[1]

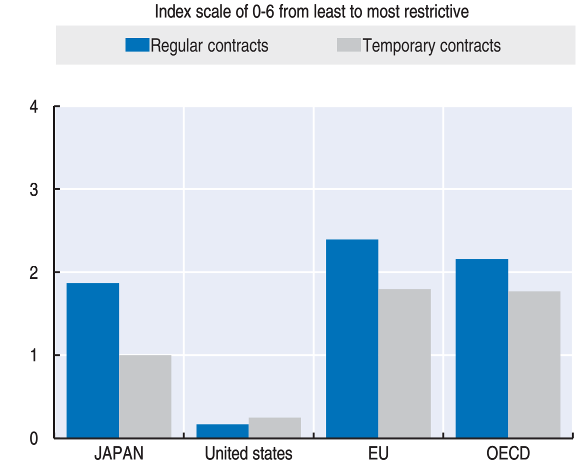


B. Agricultural support remains very high



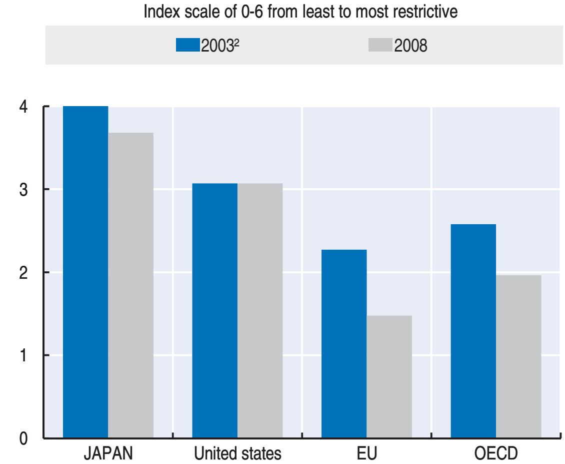
C. Employment protection legislation is relatively unbalanced, 2008

Index scale of 0-6 from least to most restrictive



D. Regulatory barriers to entry in the network sectors continue to be restrictive

Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. For the aggregates of European countries in the OECD and total OECD averages exclude Chile, Estonia, Israel and Slovenia.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases;* Chart B: OECD, *Producer and Consumer Support Estimates Database;* Chart C: OECD, *Employment Database;* Chart D: OECD, *Product Market Regulation Database.*

StatLink http://dx.doi.org/10.1787/888932374027

KOREA

The GDP per capita gap with the upper half of OECD countries continues to narrow while the labour utilisation rate remains the highest in the OECD. The remaining income gap is due to shortfalls in productivity, especially in services. This can be largely addressed by implementing further reforms in the areas below. Also, crisis-related measures to assist small and medium-sized enterprises should be scaled back to avoid supporting non-viable firms.

Priorities supported by indicators

Ease regulation of network sectors and services

Strict product market regulations obstruct competition and investment in services, where productivity is low.

Actions taken: In 2009, the Presidential Council on Competitiveness announced plans to relax 26 market entry regulations by the end of 2010. The time and cost of starting new businesses has been significantly reduced.

Recommendations: Further reduce entry barriers through regulatory reform. Relax FDI restrictions, including foreign ownership ceilings in key services, and improve the business climate to attract foreign investors.

Reduce producer support to agriculture

Agricultural support remains far above the OECD average, with a result that consumers pay more than double the world price for agricultural products.

Actions taken: The government has reduced the volume and price of its purchases of barley with a view to phasing out the programme by 2012.

Recommendations: Replace market price supports, which account for almost 90% of the support provided in 2008, with direct support for farmers.

Reform employment protection to reduce labour market dualism

Stringent job protection on regular contracts has led to increased labour market dualism, as shown by the rise in the share of temporary workers from 17% of employment in 2001 to 28% in 2007. Such dualism is detrimental to human capital formation, productivity growth and equity.

Actions taken: No action taken.

Recommendations: Weaken the incentives that encourage firms to hire non-regular workers through a comprehensive approach of reducing employment protection for regular workers and expanding social insurance coverage, while improving training opportunities for non-regular workers.

Other key priorities

Improve the efficiency of the tax system by relying more on indirect taxes

Although Korea has one of the lowest tax burdens in the OECD area, the personal and corporate income tax bases are too narrow, the tax compliance of the self-employed is weak and the system of individual consumption taxes is too complex. The system also leaves little scope for dealing with the future burdens of population ageing.

Actions taken: The three lower personal income tax rates were reduced in 2009-10 by 2 percentage points from a range of 8-26% to 6-24%. The corporate income tax rate was cut from 25% to 22% in 2009.

Recommendations: Rely more on indirect tax for additional revenue, while broadening direct tax bases.

Strengthen policies to support female labour force participation

The participation rate of women between the ages of 25 and 54 was only 62% in 2009, the fourth lowest in the OECD.

Actions taken: Eligibility for taking the one-year parental leave was expanded in 2009 from those with children up to age three to all those with children too young for primary school. In 2010, the government launched a five-year plan to promote female participation through 60 policy priorities, focused mainly on promoting the re-employment of women who left the labour force after having children.

Recommendations: Expand the availability and quality of child care, in part by relaxing price controls on private-sector suppliers. Reduce the gender gap by tackling the non-regular worker problem and curbing the use of seniority-based wages as part of a move towards performance-based pay.

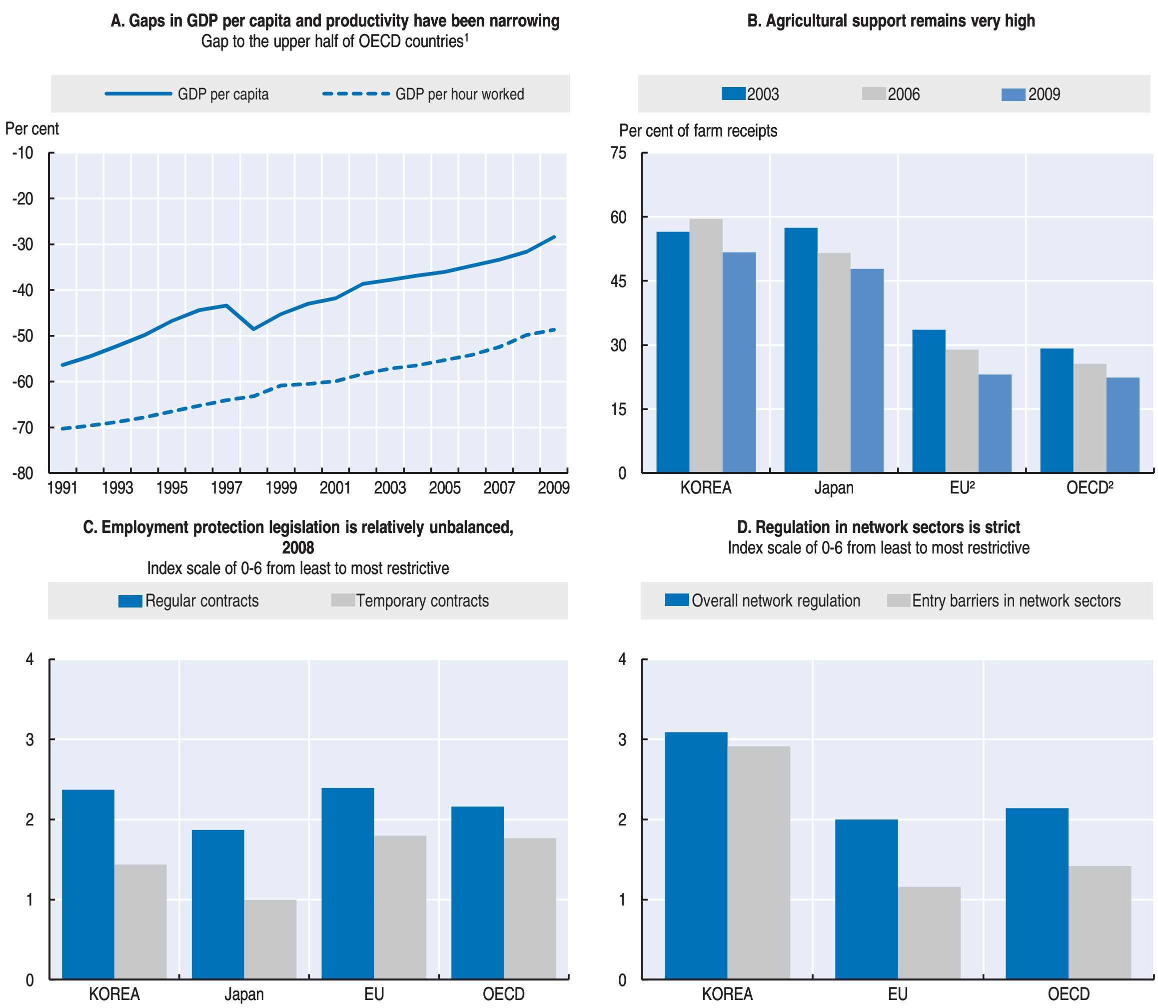
KOREA

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		4.0	4.2	3.7
Labour utilisation		–0.5	–0.4	–0.6
of which:	Employment rate	0.7	0.7	0.7
	Average hours	–1.2	–1.1	–1.3
Labour productivity		4.5	4.6	4.4
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *Producer and Consumer Support Estimates Database*; Chart C: OECD, *Employment Database*; Chart D: OECD, *Product Market Regulation Database.*

StatLink http://dx.doi.org/10.1787/888932374046

LUXEMBOURG

GDP per capita is the highest in the OECD despite a fall during the recession. Labour productivity has stalled as the result of labour hoarding and going forward the growth path is likely to be weaker than over recent decades. Major reforms of the school system undertaken in recent years will improve education prospects for residents, but reforms are needed in other areas discussed below.

Priorities supported by indicators

Improve work incentives

Weak work incentives generated by high social benefits create inactivity traps and thereby reduce employment among Luxembourg residents.

Actions taken: No action taken to reform the unemployment benefit system. Managerial measures are underway to improve activation by addressing organisational weaknesses in the public employment service (ADEM).

Recommendations: Lower replacement rates under ongoing social benefits, and reduce unemployment benefits progressively throughout the period of entitlement as the recovery firms. Tighten unemployment insurance eligibility conditions for young people without work histories. Strengthen activation requirements and improve the cost effectiveness of labour market programmes.

Reduce disincentives to continued work at older ages

Labour force participation among older workers is low as the result of early retirement schemes and high implicit taxes on continued work embedded in the old age pension system.

Actions taken: No action taken to modify the pension system, but part of the increase in pensions due in January 2011 has been delayed to 2012.

Recommendations: Abolish early retirement schemes to raise the effective retirement age. A major reform of pensions should include progressively reducing the replacement rate, limiting credits for time spent outside work, introducing actuarial fairness around the standard retirement age and indexing that standard age to longevity.

Increase competition in the domestically-focused services sector

Product market regulation in the domestic economy is restrictive and competition in the professional services and retail sectors is weak.

Actions taken: No action taken, and transposition of the EU Services Directive remains to be legislated.

Recommendations: For professional services, remove restrictions on advertising, facilitate co-operation between professions, and scrap minimum or reference prices. Shop opening hours should be made more flexible. The competition authority should be re-organised into a single body and be given sufficient resources.

Other key priorities

Improve the functioning of the housing market

The pressures from cross-border workers on the transport system is increased by cumbersome planning regulations and low property taxes that lead to high housing costs in Luxembourg.

Actions taken: The 2008 Housing Pact Law aims to increase incentives for local authorities to boost housing development, and a five-year review of the procedure for construction authorisations is underway.

Recommendations: Overhaul the planning system so as to facilitate house building. Reduce implicit tax subsidies to home ownership and incentives to hoard building plots.

Ease restrictive employment protection legislation

Strict employment protection legislation hinders job opportunities for under-represented groups in the labour market and undermines the overall flexibility of the economy.

Actions taken: No action taken.

Recommendations: Ease conditions on collective dismissal and social plans. Lengthen trial periods under regular contracts for the low-skilled. Reduce restrictions on temporary contracts by extending their total duration and facilitating renewals.

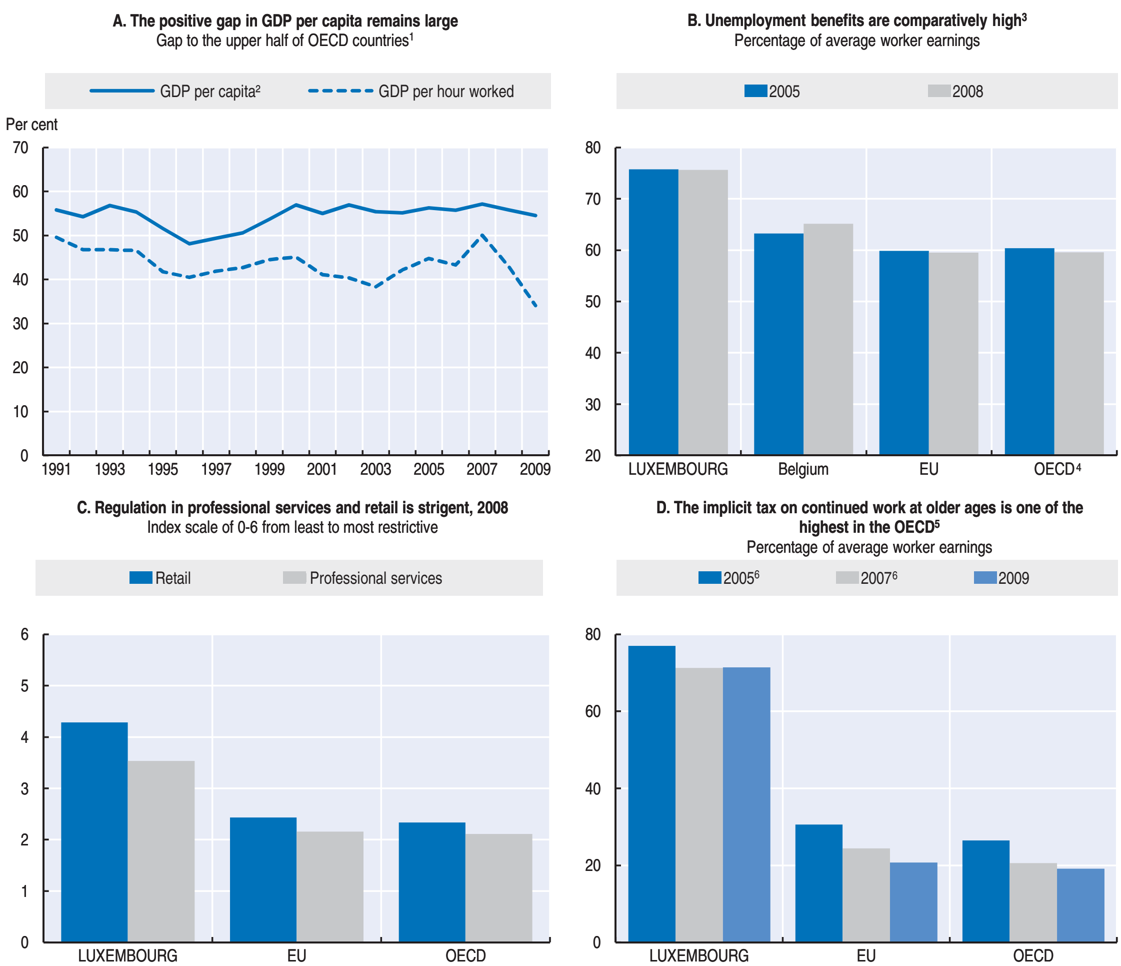
LUXEMBOURG

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		2.7	3.2	2.2
Labour utilisation		1.2	1.7	0.8
of which:	Employment rate	2.1	2.5	1.6
	Average hours	–0.8	–0.8	–0.8
Labour productivity		1.4	1.5	1.3
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. The population is augmented by the number of cross-border workers in order to take into account their contribution to GDP.
3. Average of replacement rates for short and long term unemployed persons who earned 67% and 100% of average worker earnings at the time of losing job.
4. Average of OECD countries excluding Chile and Israel.
5. Implicit tax on continued work embedded in the regular old-age pension scheme for 60-year-olds.
6. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *Benefits and Wages Database*; Chart C: OECD, *Product Market Regulation Database*; Chart D: Duval, R. (2003), "The Retirement Effects of Old-Age Pension and Early Retirement Schemes in OECD Countries", *OECD Economics Department Working Papers*, No. 370 and OECD calculations.

StatLink http://dx.doi.org/10.1787/888932374065

MEXICO

Mexico has one of the largest GDP per capita gaps with respect to the richest 50% of OECD countries, which is almost entirely due to a persistent gap in labour productivity. Mexico is bringing its competition law in line with international best practice, but further actions in the following areas are needed to address the productivity shortfall.

Priorities supported by indicators

Raise achievement in primary and secondary education

Scores on international student tests (PISA) are weaker than in most OECD countries, holding back productivity growth and slowing the adoption of new technologies.

Actions taken: As part of the framework of the Alliance for Quality Education between the government and the main teachers' union, spending on school infrastructure has increased and around 20 000 schools have been renovated. In 2010 a bonus is being paid out to schools achieving high scores on the national student test.

Recommendations: Provide better support to schools to focus on improving learning outcomes, and hold directors and teachers accountable for results. Set clear national standards of teaching practice and student performance, aligned with a national curriculum. Improve initial teacher preparation, professionalise recruitment, selection and evaluation of teachers, and link teachers' professional development to schools' needs. Strengthen school leadership and management and build capacity to support school autonomy and social participation.

Reduce barriers to firm entry

Regulatory barriers to entry in key network industries (*e.g.* telecommunications and electricity) and burdensome regulations for start-ups hamper competition and productivity growth.

Actions taken: Assisted by the OECD, the government launched in 2007 a process for strengthening competitiveness in Mexico by promoting regulatory and competition policy reform. One outcome is the launch of an online one-stop shop that reduces the time to start a new business significantly. Authorities have initiated phone number portability and given permits to commercialise or resell mobile phone services. In 2010 the government completed two competitive bidding processes in telecommunications (radio-electric spectrum and dark optical fibre network).

Recommendations: Increase the effectiveness and enforceability of competition-enhancing access regulations in network industries. Remove legal obstacles to private investment in the electricity sector and fixed line telephony. Reduce regulatory "red tape" for start-ups.

Reduce barriers to foreign ownership

Restrictions on FDI still in place in some sectors curb competition and innovation.

Actions taken: A new law reducing ownership restrictions in telecommunications has been approved in the lower chamber of Congress. Approval in the upper chamber is pending.

Recommendations: Ease restrictions on FDI in services and infrastructure, especially in the electricity sector and fixed line telephony.

Other key priorities

Improve the rule of law

A lack of legal certainty holds back competition and investment.

Actions taken: A reform bill that strengthens competition law has passed the lower chamber of Congress. Approval in the upper chamber is pending. A review of the existing stock of regulations was launched by the President in early 2010 to increase regulatory certainty, among other objectives.

Recommendations: Improve the rule of law by clarifying property rights and ensuring more effective and predictable law enforcement. In the area of competition law, enhance the investigative powers of the competition commission (the CFC), increase the level of fines for collusion, and reduce the length of judicial procedures by reforming the appeals system (*amparos*).

Reform the state-owned oil company

Weak incentives for efficient operation and investment have contributed to a fall in oil production.

Actions taken: A comprehensive energy sector reform was implemented in 2008-09, which establishes a statutory increase in PEMEX independence and accountability, and allows cash incentives for contractors that meet pre-specified performance objectives. However, profits and property rights on hydrocarbons will not be shared. PEMEX's investment will be excluded from the fiscal balance rule.

Recommendations: Improve the governance of PEMEX by strengthening accountability for efficient operation. Continue facilitating risk and profit sharing with other companies to ease access to technologies. Lift production and investment constraints in the sector.

MEXICO

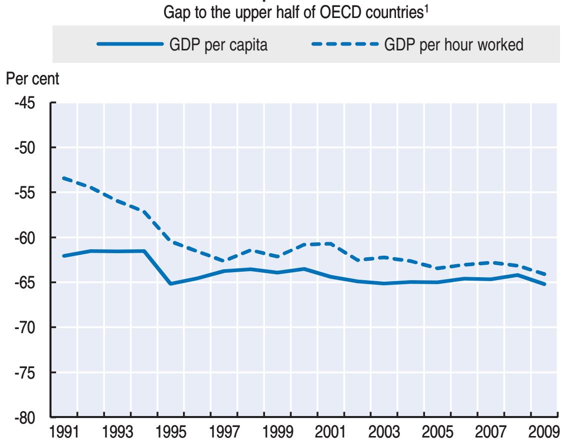
Structural indicators

Average annual trend growth rates, per cent

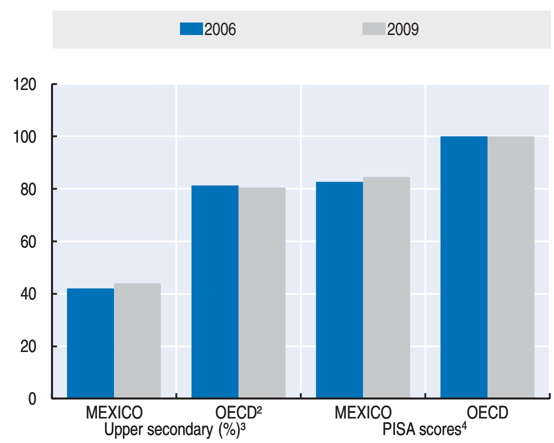
		1999-2009	1999-2004	2004-09
GDP per capita		1.4	1.5	1.3
Labour utilisation		0.7	0.7	0.7
of which:	Employment rate	0.8	0.8	0.8
	Average hours	–0.1	0.0	–0.1
Labour productivity		0.7	0.8	0.6
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

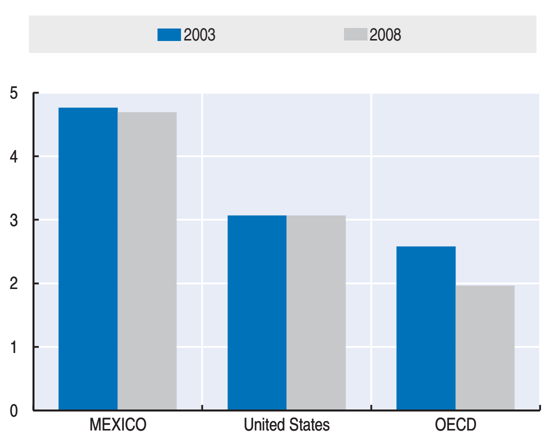
A. Gaps in GDP per capita and productivity are wide and persistent
Gap to the upper half of OECD countries[1]



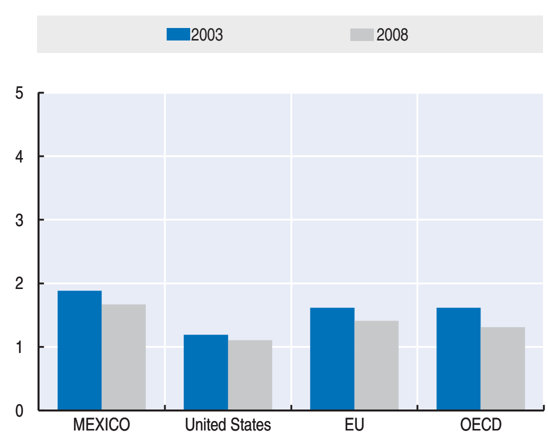
B. Upper secondary school graduation and achievement could be further enhanced



C. Barriers to entrepreneurship in network sectors remain high
Index scale of 0-6 from least to most restrictive



D. Barriers to foreign ownership should be lowered further[5]
Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Average of OECD countries excluding Australia, Austria, Belgium, Estonia, France and the Netherlands.
3. First-time graduation rates for single year of age at upper secondary level, years 2006 and 2008.
4. Average score of student performance in mathematics, science and reading. Index OECD = 100.
5. The FDI regulation index looks only at statutory restrictions and does not assess the manner in which they are implemented.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Charts B: OECD (2010), *Education at a Glance* and OECD, *PISA 2009 Database*; Charts C and D: OECD, *Product Market Regulation Database*.

StatLink http://dx.doi.org/10.1787/888932374084

NETHERLANDS

GDP per capita is at par with the average of the upper half of OECD countries, due to a combination of high hourly productivity and employment offset by a low number of hours worked per employee. In 2009, the government introduced a number of policy measures to increase activation and hours worked, but in order to improve economic performance other reforms are necessary in the following areas.

Priorities supported by indicators

Ease employment protection legislation for regular contracts

Employment protection legislation for regular contracts imposes either high severance payments (the court route) or lengthy bureaucratic barriers. This increases the risks associated with hiring, limiting the possibilities for workplace reorganisation and the diffusion of new technologies, ultimately hurting productivity.

Actions taken: In 2009 local courts adopted guidelines limiting severance payments awarded through judicial procedures, though such payments remains generous compared with other countries. The previous government proposed to cap severance pay at one year's salary for incomes above EUR 75 000.

Recommendations: Make the system simpler and more predictable. The rules governing layoffs should be clearly specified in law with appeal to local courts only possible as an *ex post* option. Severance payments for older workers should be capped with the cap decreasing as they approach retirement.

Reform the disability benefit schemes

The share of working-age population receiving disability benefits remains high.

Actions taken: Starting from 2010, new participants in the programme for the young disabled (Wajong) are entitled to job support rather than passive income support. Participants are assessed upon entry and again at the age of 27, and can only subsequently be transferred to passive income support.

Recommendations: Apply recently tightened entry controls to all existing benefit recipients and enhance monitoring mechanisms. Benefits should be gradually de-coupled from past earnings over the disability spell. They should also be excluded from wage agreements.

Lower marginal effective tax rates

Marginal effective tax rates are high, in particular for low-income households and second earners, lowering their participation rates and hours worked.

Actions taken: The transferability of the individual tax credit is being phased out gradually (by 2025), reducing the marginal taxation of low-income second earners. Starting from 2009 the combination tax credit is income dependant to encourage lower-earning partners to extend working hours.

Recommendations: The transferability of the individual tax credit should be phased out more rapidly to reduce the effective marginal tax rate that low-income spouses face. Likewise, more of the family-income based child tax credit should be shifted to the individual or second-earner child tax credit. The tapering-off rate for housing and child benefits should be further flattened while certain work-related entitlements and tax credits could be conditioned on the number of hours worked.

Other key priorities

Increase the scope of the unregulated part of the housing market

The rigid housing market dampens geographical labour mobility and contributes to high levels of congestion, with detrimental effects on productivity.

Actions taken: No action taken.

Recommendations: Housing market policies should be reformed by deregulating the rental sector, shifting the taxation of housing (cutting transaction taxes and increasing property taxes) and easing strict land regulation.

Reform the unemployment benefit system

The high level and maximum duration of unemployment benefits lower job-search incentives.

Actions taken: In 2009 the government tightened job requirements for the long-term unemployed and introduced a temporary top-up on the initial salary in order to make work pay.

Recommendations: Unemployment benefit duration should be tempered and benefits should fall more rapidly throughout the unemployment spell. The cap on unemployment benefits should be lowered to further enhance the job-search incentives of the high-skilled unemployed.

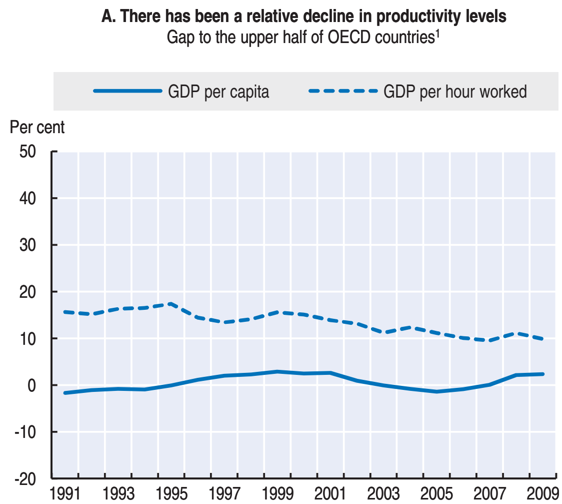
NETHERLANDS

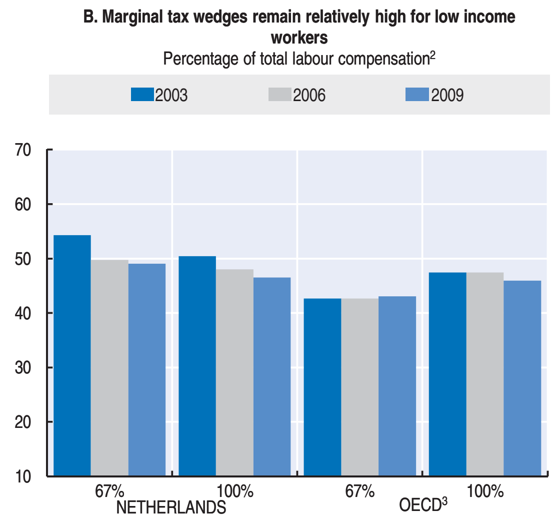
Structural indicators

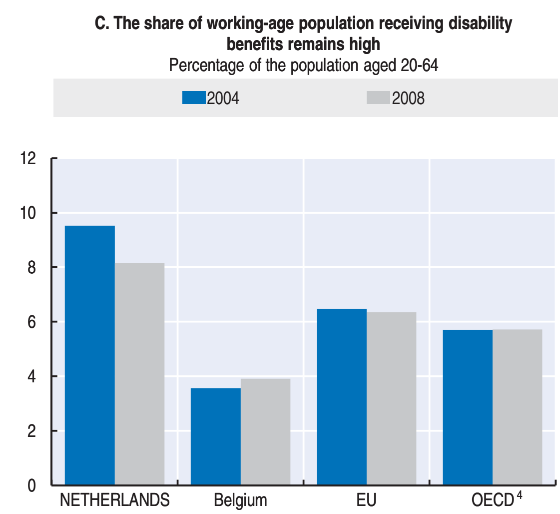
Average annual trend growth rates, per cent

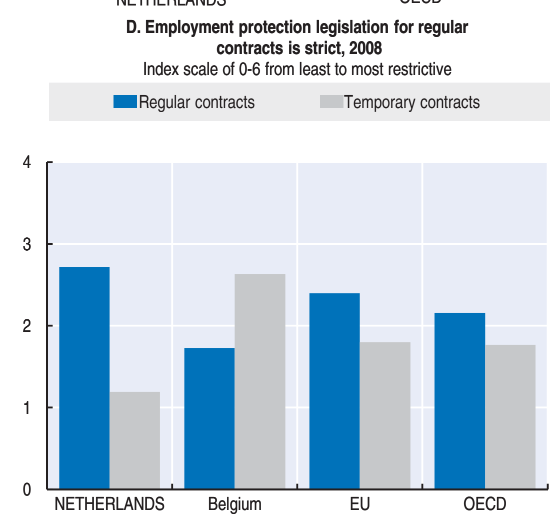
		1999-2009	1999-2004	2004-09
GDP per capita		1.7	2.0	1.5
Labour utilisation		0.5	0.6	0.4
of which:	Employment rate	0.6	0.8	0.3
	Average hours	0.0	–0.2	0.1
Labour productivity		1.2	1.4	1.1
of which:	Capital intensity	0.6	0.6	0.6
	Multifactor productivity	0.6	0.7	0.4

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database*.









1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Evaluated at 67% and 100% of average earnings for a single person with no child.
3. Average of OECD countries excluding Chile, Estonia, Israel and Slovenia.
4. Excluding Chile.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *Taxing Wages Database*; Chart C: OECD (2010), *Sickness, Disability and Work: Breaking the Barriers: A Synthesis of Findings across OECD Countries*; Chart D: OECD, *Employment Database*.

StatLink http://dx.doi.org/10.1787/888932374103

NEW ZEALAND

A large gap in GDP per capita persists relative to the upper half of OECD countries, which is entirely due to low labour productivity. There has been progress on negotiating regional free trade agreements, reducing tax distortions and pricing carbon emissions, but reforms in the following areas are still needed.

Priorities supported by indicators

Reduce barriers to competition in network industries

Significant barriers to competition in electricity transport and telecommunications deter investment and innovation.

Actions taken: An Electricity Authority was established in October 2010, and a Productivity Commission is to be established in early 2011 – both arms-length Crown agencies. The government plans to regulate mobile termination charges in the interest of consumers. The government is helping to fund a major roll-out of broadband.

Recommendations: Dismantle barriers to competition in international air transport and rail. Fund investments in road, energy, and water and use tolls and congestion pricing to restrain demand. Continue to review and clarify the competition framework in network industries. Ensure greater broadband penetration. Remove all remaining tariffs.

Relax barriers to foreign direct investment and reduce regulatory opacity

Although narrow in scope, screening procedures on foreign direct investment might deter investment. More broadly, extensive improvements in regulation are needed.

Actions taken: With "Better Regulation, Less Regulation", the government launched several enhancements to regulatory quality management and a major regulatory review programme. A Regulatory Responsibility Taskforce has also been set up. However, the FDI screening regime for sensitive land has been further tightened.

Recommendations: Have clearer, fewer and more efficient regulations as part of the government's programme to raise living standards. Pass the Regulatory Responsibility Bill. Remove consent rules for foreign acquisitions of 25% or more in larger firms, and clarify the criteria for protecting "sensitive land". Continue to streamline environmental impact assessments for investment projects.

Reduce educational underachievement among specific groups

Wide gaps in achievement emerge at an early age. Maori and Pacifica students disproportionately leave school without basic skills and with poor labour market prospects.

Actions taken: The government has: introduced a "Youth Guarantee" ensuring access to education leading to worthwhile qualification and employment; developed targeted initiatives aimed at improving early education for disadvantaged communities with a special focus on raising Maori and Pacifica participation; and established an Education Workforce Advisory Group on how to raise the overall quality of teaching across the school system.

Recommendations: Provide early intervention to raise literacy and numeracy levels of weaker students. Support the ongoing development of a high-quality teaching workforce by improving teacher education and ongoing learning and development, strengthening professional leadership and enhancing recognition, reward and progression within the teaching profession.

Other key priorities

Raise the effectiveness of R&D support

Lack of R&D credits and relatively low direct public R&D funding contribute to below-average R&D intensity.

Actions taken: None.

Recommendations: Reinstate the R&D tax credit, cull less efficient research grants, boost direct public R&D funding and improve R&D policy co-ordination. Orient immigration, education, and labour-market policies toward supplying more innovation skills.

Improve health-sector efficiency

The health-care sector suffers from weak efficiency incentives and, consequently, low productivity.

Actions taken: The health-care sector has been reorganised to improve public managerial accountability.

Recommendations: Boost value for money in health care by developing better output and quality measures, strengthening public health providers' accountability for performance, and using more competitive contracting for public funds. Continue to improve access and service quality for minority groups with an increased focus on the prevention and management of chronic illnesses.

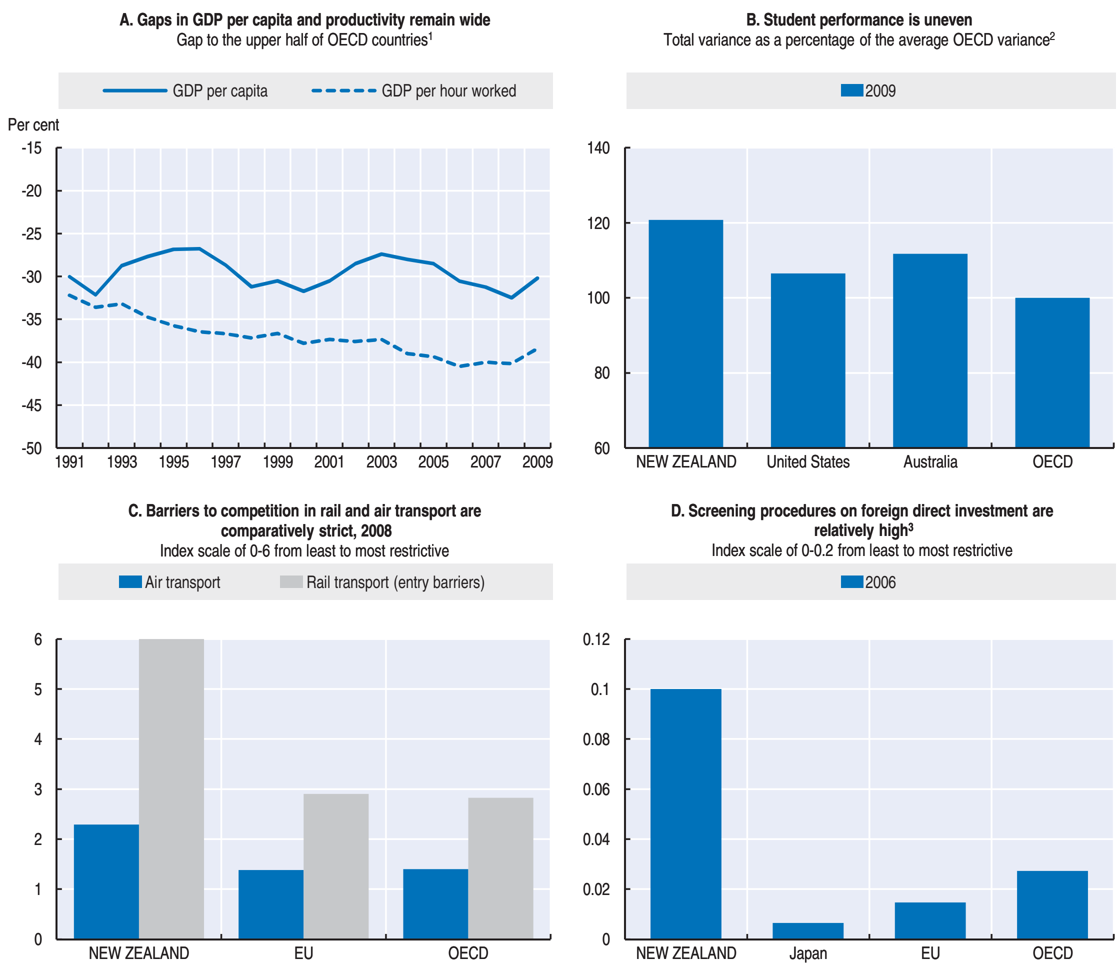
NEW ZEALAND

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		1.6	1.9	1.3
Labour utilisation		0.6	0.8	0.3
of which:	Employment rate	0.9	1.1	0.8
	Average hours	–0.3	–0.3	–0.4
Labour productivity		1.0	1.1	1.0
of which:	Capital intensity	1.2	1.0	1.3
	Multifactor productivity	–0.1	0.1	–0.3

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. The variance components, in reading performance only, were estimated for all students in participating countries with data on socio-economic background and study programmes. The variance is calculated from the square of the standard deviation for the students used in the analysis.
3. The FDI regulation index looks only at statutory restrictions and does not assess the manner in which they are implemented.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *PISA 2009 Database*; Charts C: OECD, *Product Market Regulation Database*; Chart D: Koyama, T. and S. S. Golub (2006), "OECD's FDI Regulatory Restrictiveness Index: Revision and Extension to More Economies", *OECD Economics Department Working Papers*, No. 525.

StatLink http://dx.doi.org/10.1787/888932374122

NORWAY

Norway has maintained its productivity lead (including in the non-petroleum sector) over most OECD countries, and labour utilisation is also high. Structural reform in the following areas would contribute to further increase economic performance.

Priorities supported by indicators

Reform disability and sickness benefit schemes

Unemployment is low but the number on sick-leave and disability benefit recipients is well above the level implied by health indicators, reducing labour supply.

Actions taken: No action taken. Since 2008, employers and employees are supposed to plan for re-entry of workers on sick leave or disability pensions, but workers still tend to respond rationally to a generous system by reducing labour supply.

Recommendations: Require applications for disability pensions to be assessed and periodically reviewed by doctors independent of applicants and their employers and/or reduce replacement rates. With due allowance for the constraints of their disability, subject the partially disabled to the same conditionality as unemployment benefit recipients.

Increase product market competition

Barriers to entry and public ownership reduce competition and may result in lower productivity growth.

Actions taken: Some small backward measures were taken in 2010: the exemption of certain books from price maintenance prohibition was extended for four years, even though higher educational books will be subject to free pricing from 2011. New controls on retail outlets to limit their environmental impact were introduced.

Recommendations: Reduce legal barriers to entry in some services, notably retail and post, and ensure that the significant market power of the partially publicly-owned former telecom monopoly does not hinder new entry. Ensure that environmental concerns are genuine, and are not used to protect incumbents from new entrants. Reduce public ownership, seeking other ways to secure public interest objectives in industries such as finance and petroleum.

Reduce producer support to agriculture

The Norwegian agricultural sector, though small, is one of the most heavily protected in the OECD, encouraging inefficient use of resources.

Actions taken: No action taken.

Recommendations: Progressively cut price support and import restrictions to bring domestic food prices more in line with international levels. Where support is for regional, social or environmental purposes, use more targeted and transparent policies, cutting the link with agricultural output.

Other key priorities

Strengthen performance in secondary education

Educational outcomes, as measured by international student test (PISA) scores, are poor considering the high level of expenditure.

Actions taken: From 2009, candidates for teacher training must meet more stringent entry requirements. Municipalities must prepare reports using national indicators, but not including publicising information on school performance.

Recommendations: Reduce the number of schools to benefit from scale and scope economies, and focus more on the needs of the children of migrants. Increase school and teacher accountability through wider use of performance information including value added indicators. Include such measures of school performance as a criterion in assessment of school principals. Improve teacher training and career structures.

Improve the efficiency of the tax structure

High marginal income tax rates and low residential property taxation distort incentives for labour supply and saving.

Actions taken: No recent action on income tax. The discount applied to real estate in the wealth tax is to be reduced from 2010, but not eliminated.

Recommendations: Reduce marginal income tax rates and shift the composition of tax revenue towards consumption and property taxes (based on market values).

NORWAY

Structural indicators

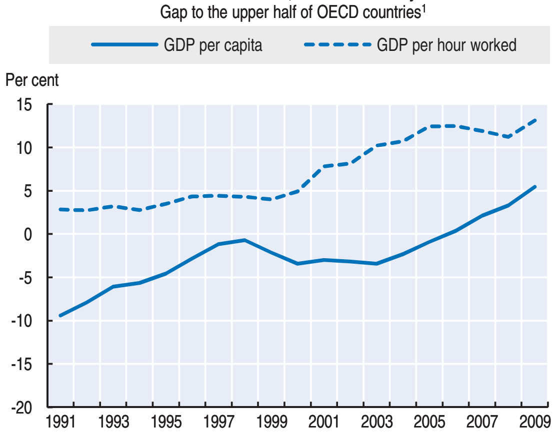
Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		2.5	2.0	3.0
Labour utilisation		0.1	–0.2	0.4
of which:	Employment rate	0.3	0.3	0.4
	Average hours	–0.2	–0.5	0.0
Labour productivity		2.4	2.1	2.7
of which:	Capital intensity	0.4	0.3	0.5
	Multifactor productivity	2.0	1.9	2.2

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

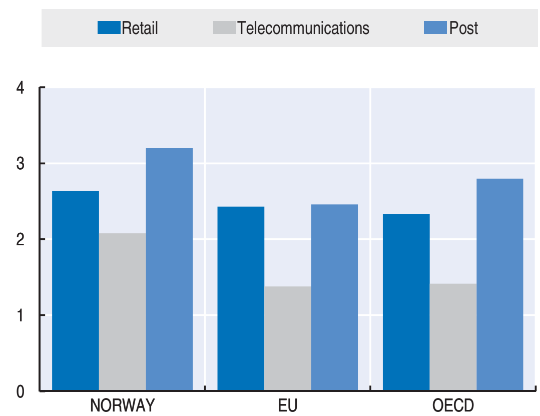
A. The positive gaps in GDP per capita and productivity have increased further, mainland Norway

Gap to the upper half of OECD countries[1]

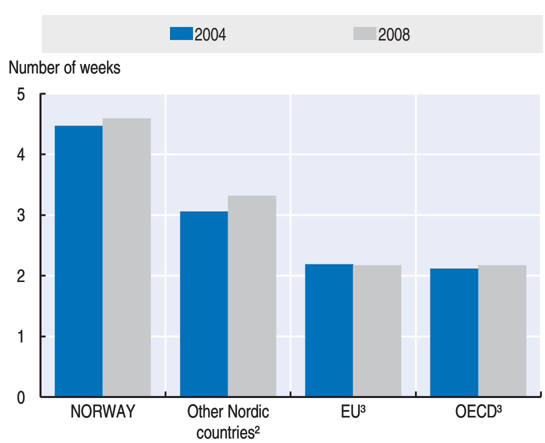


B. Barriers to competition in network sectors are high, 2008

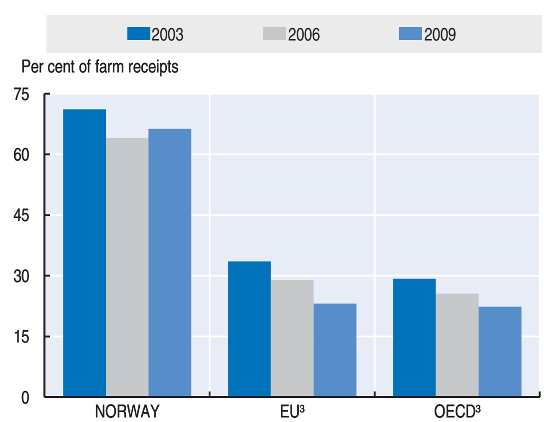
Index scale of 0-6 from least to most restrictive



C. The number of weeks per employee lost due to sickness is high and rising



D. Agricultural support remains very high



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs). Data refer to GDP 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 the petroleum fund holds abroad are not included.
2. Average of Denmark, Finland and Sweden.
3. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *Product Market Regulation Database*; Chart C: OECD (2010), *Sickness, Disability and Work: Breaking the Barriers: A Synthesis of Findings across OECD Countries*; Chart D: OECD, *Producer and Consumer Support Estimates Database*.

StatLink http://dx.doi.org/10.1787/888932374141

POLAND

While GDP per capita has been catching up quickly over the last decade, the shortfall relative to the upper half of the OECD countries remains large primarily due to a labour productivity gap. The government has taken measures to attract foreign direct investment with a view to modernising the economy and increasing capital intensity. A number of other reforms need to be implemented, particularly in the following areas.

Priorities supported by indicators

Reduce public ownership and lower barriers to entrepreneurship

The State has kept controlling stakes in strategic energy producers. Starting a business remains costly and is slow.

Actions taken: A privatisation programme encompassing 800 firms, launched for 2009 and 2010, will be partly accomplished, generating receipts of about 2% of GDP. The government has announced further privatisation projects for 2011 to 2013. Barriers to entrepreneurship have recently been lowered with the creation of one-stop shops.

Recommendations: Further privatisation will be needed after the current privatisation programme is completed. Reduce state interference in privatised companies, and shorten the time needed for setting up a new firm.

Improve the efficiency of the education system

The number of places in pre-school childcare facilities is insufficient. Public higher-education institutions lack quality control and have little financial autonomy as they are not allowed to levy tuition fees. Access to student loans is restricted.

Actions taken: A law promoting attendance in public pre-schools for five-year old children was passed in 2009.

Recommendations: Improve provision of free pre-school education for those aged three to five. Introduce tuition fees in public higher-education institutions along with a more accessible system of means-tested grants and student loans with income-contingent repayment. Reinforce quality assessment, and strengthen transparent promotion criteria for professors in tertiary education. Treat public and private higher education institutions equally for regulatory and funding purposes.

Reform the tax and benefit system

The tax wedge in Poland is, relative to OECD peers, slightly higher than the average. Early-retirement schemes cover a considerable number of employees of the police and armed forces and those who lost their jobs prior to retirement.

Actions taken: A cut in personal income tax rates in 2009 reduced the tax wedge. The government significantly tightened access to early retirement (bridge pensions) resulting from difficult work conditions.

Recommendations: Further reduce the tax wedge. Tighten eligibility for early retirement and reform the retirement and social security system for farmers.

Other key priorities

Improve transport, communication and energy infrastructure

The quality of Poland's transport infrastructure and fixed broadband penetration are among the lowest in the OECD. Electricity generation relies heavily on outdated coal-fired plants.

Actions taken: Transport infrastructure is being upgraded with the help of EU funds.

Recommendations: Enhance transport and communication infrastructure. Facilitate competition in telecommunications and energy generation by allowing non-discriminatory access to the network. Encourage investment in low-carbon electricity generation.

Reform housing policies

The housing market suffers from the absence of zoning plans, labour shortages in construction and a large informal rental market due to strict rent controls.

Actions taken: The government has lifted rent restrictions, lowered legal protection of tenants and generalised the lower tax rate of 8.5% on rental income to curb the informal rental market. It also introduced measures to promote vocational education that will be especially important for the construction sector.

Recommendations: Make the release of zoning plans by municipalities mandatory, introduce compulsory escrow accounts to protect buyers' advances, further relax rent controls, and ease labour shortages by strengthening vocational training.

POLAND

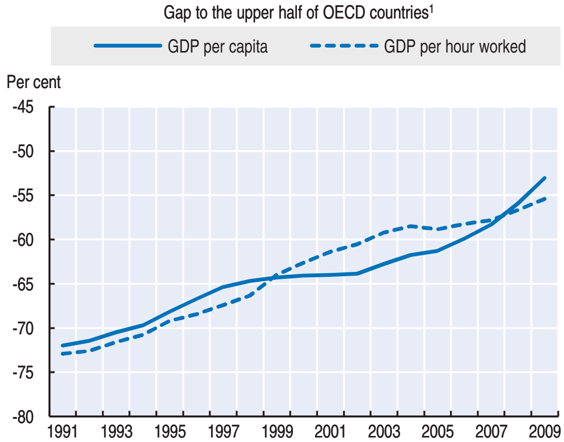
Structural indicators

Average annual trend growth rates, per cent

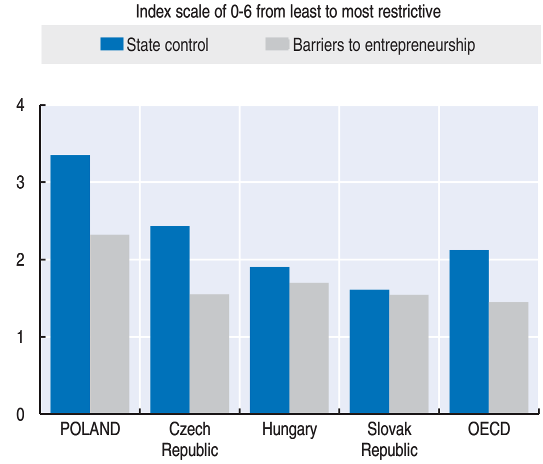
		1999-2009	1999-2004	2004-09
GDP per capita		4.2	3.5	4.8
Labour utilisation		0.4	–1.4	2.2
of which:	Employment rate	0.4	–1.3	2.1
	Average hours	0.0	–0.2	0.1
Labour productivity		3.8	5.0	2.6
of which:	Capital intensity	1.2	2.0	0.4
	Multifactor productivity	2.6	3.1	2.2

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

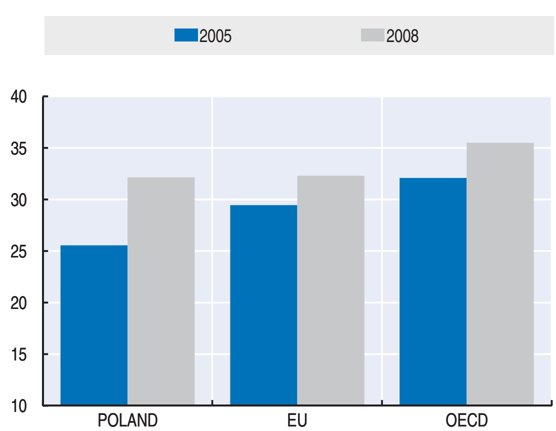
A. The large gaps in GDP per capita and productivity continue to narrow
Gap to the upper half of OECD countries[1]



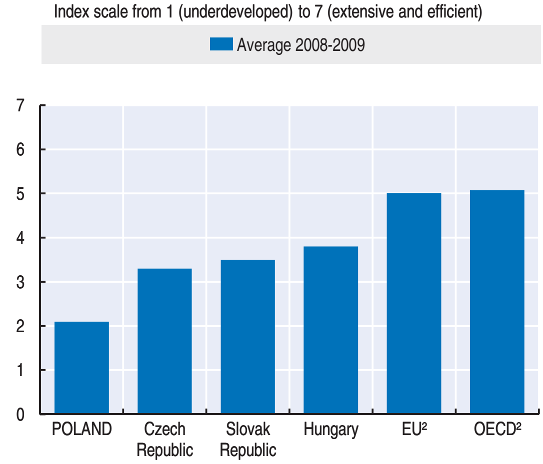
B. State control and barriers to entrepreneurship are high, 2008
Index scale of 0-6 from least to most restrictive



C. Tertiary educationnal attainment is catching up
Percentage of population aged 25-34



D. Road transport infrastructure quality is the lowest of OECD countries
Index scale from 1 (underdeveloped) to 7 (extensive and efficient)



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook No. 88 Databases*; Chart B: OECD, *Product Market Regulation Database*; Chart C: OECD (2010), *Education at a Glance*; Chart D: OECD (2010), *OECD Economic Surveys: Poland.*

StatLink http://dx.doi.org/10.1787/888932374160

PORTUGAL

GDP per capita relative to the upper half of OECD countries has declined over the past decade, with only a modest reversal during the recent crisis. This decline has been mainly accounted for by labour utilisation, but lower productivity alone explains the large gap in income levels. Some efforts have recently been made to accelerate pension reform implementation and to make public administration more efficient. Further reforms in the following areas are still needed to improve economic performance.

Priorities supported by indicators

Improve secondary and tertiary educational attainment

Still low secondary and tertiary educational attainment weighs heavily on productivity and income levels.

Actions taken: The authorities raised the compulsory education age from 15 to 18 in 2009, revised teacher performance evaluation in 2010 and have continued to expand vocational educational and training (VET) and to implement tertiary education reforms.

Recommendations: Enhance career guidance and employers' involvement in VET. Reduce school-year repetition through more efficient interventions targeted to at-risk individuals. Implement training for teacher evaluation and link it to school evaluation. Continue to upgrade working adults' qualifications, at both secondary and tertiary levels. Ensure systematic monitoring and external assessment of all major reforms.

Strengthen competition in non-manufacturing sectors

Insufficient competition in network industries, retail and professional services hampers resource allocation and overall productivity levels.

Actions taken: The authorities increased the threshold surface limit for regulation of large outlets in 2009 and introduced legislation to make their opening hours more flexible in 2010. Sectoral regulators have lowered mobile phone termination charges and are introducing performance contracts in railways in 2010.

Recommendations: Foster competition in retail trade by further easing large outlet regulations and allowing updating of old rental contracts, which favour inefficient firms. Make licensing less restrictive in professional services. Promote competition in railways and ensure effective implementation of performance contracts. When financial conditions improve, downscale public ownership in transportation.

Reduce labour market dualism

Reformed but still-high job protection on regular contracts leads to labour market dualism, while the unemployment benefit system discourages job search by older workers and is inequitable.

Actions taken: The authorities imposed a cap on benefit replacement rates and made refusal of job offers more difficult in 2010.

Recommendations: Further reduce job protection on regular contracts. Reduce unemployment benefit generosity for older workers, by making benefit duration, replacement rates and their reduction throughout the unemployment spell age-independent. To better cover young and temporary workers, broaden benefit eligibility by reducing the required contributory period.

Other key priorities

Reduce administrative burdens on business at the local level

High administrative burdens at the local level, especially in licensing, hamper entrepreneurship and productivity.

Actions taken: A small but growing number of municipalities have been joining Simplex Autárquico, a simplification programme. In 2010 the authorities have announced legislation to abolish licensing for some services.

Recommendations: Foster wide participation in Simplex Autárquico and broaden its scope, especially as regards collaboration between central and local authorities in licensing.

Simplify the tax system and broaden tax bases

Compliance costs are high, partly due to extensive tax expenditures. These also lower tax collection and are often distortive or inequitable.

Actions taken: The tax administration has substantially sped up the handling of tax disputes and private ruling requests, and continued to make progress in electronic tax filing and payment.

Recommendations: Increase coordination between tax and social security agencies, and reduce tax reporting requirements for small firms. Substantially curb tax expenditures for all types of taxes.

PORTUGAL

Structural indicators

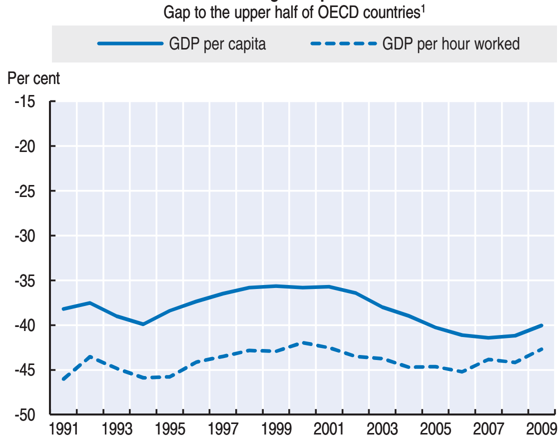
Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		1.0	1.5	0.6
Labour utilisation		–0.4	–0.2	–0.6
of which:	Employment rate	0.0	0.3	–0.3
	Average hours	–0.4	–0.5	–0.4
Labour productivity		1.4	1.6	1.2
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

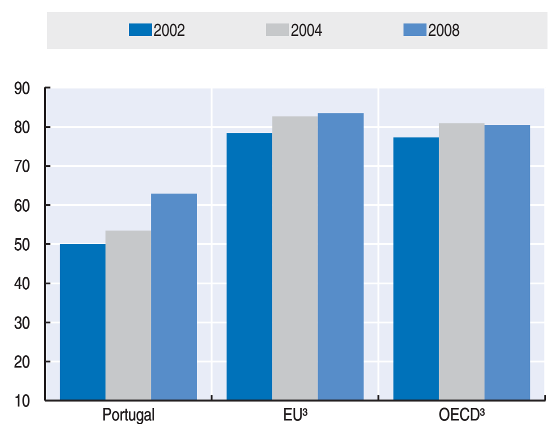
Source: Estimates based on OECD (2010), *OECD Economic Outlook No. 88: Statistics and Projections Database.*

A. Gaps in GDP per capita and productivity remain large and persistent

Gap to the upper half of OECD countries[1]

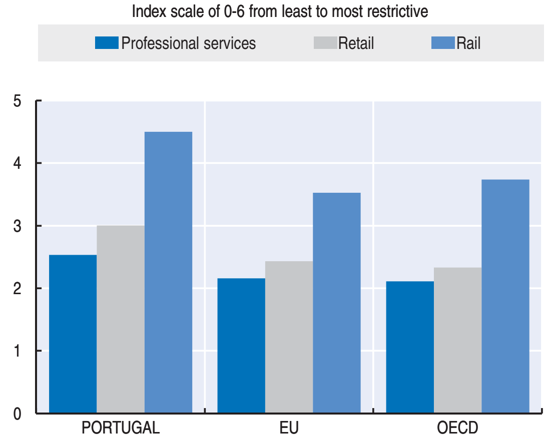


B. Upper secondary education graduation rates need to be improved[2]



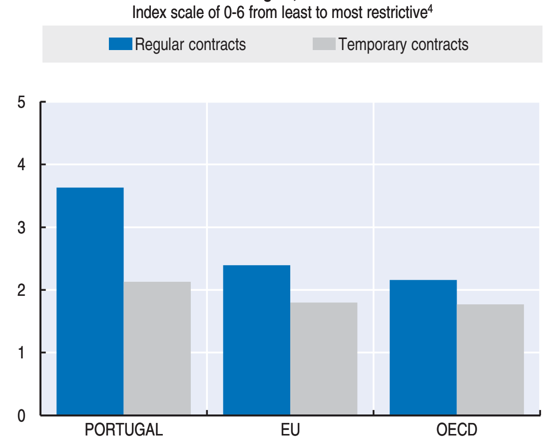
C. Barriers to competition in non-manufacturing sectors are substantial, 2008

Index scale of 0-6 from least to most restrictive



D. Employment protection legislation for permanent workers is stringent, 2009

Index scale of 0-6 from least to most restrictive[4]



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. First-time graduation rates for single year of age at upper secondary level.
3. Average of European countries in the OECD. EU and OECD averages exclude Australia, Austria, Belgium, Estonia, France and the Netherlands.
4. 2009 for Portugal, 2008 for the EU and the OECD.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook No. 88 Databases*; Chart B: OECD (2010), *Education at a Glance*; Chart C: OECD, *Product Market Regulation Database*; Chart D: OECD, *Employment Database.*

StatLink http://dx.doi.org/10.1787/888932374179

RUSSIA

The income gap with OECD countries narrowed rapidly until 2008, but remained large and widened in 2009, as Russia was relatively hard-hit by the economic and financial crisis. This income gap is almost entirely attributable to a labour productivity shortfall, making productivity-enhancing reforms a priority.

Priorities supported by indicators

Lower barriers to trade and foreign direct investment

Barriers to international trade and FDI are high compared to OECD countries, undermining competition and technology diffusion.

Actions taken: The Law on Strategic Industries came into force in 2008, defining 42 sectors in which foreign acquisitions require prior government approval. Several discriminatory trade measures were introduced during the crisis, and some have been extended.

Recommendations: Discontinue discriminatory trade measures introduced during the crisis. Reduce tariff levels and dispersion. Shorten the list of strategic sectors.

Reduce state control over economic activity

State control remains significant due to a high degree of public ownership and influence on economic activity, which depresses competition and thereby hinders innovation and productivity growth.

Actions taken: The government stepped up privatisation efforts in 2010. The list of strategic enterprises for which privatisation requires presidential approval has been reduced. The government has promoted the appointment of independent directors to the boards of state-owned enterprises.

Recommendations: Further reduce the list of strategic enterprises. Increase the use of regulatory alternatives to direct interventions.

Raise the effectiveness of innovation policy

Innovation potential is substantial, reflecting a well-developed science base, the high quality of science and engineering education and significant public resources spent on research and development; however, incentives for private research and development are overly weak, limiting productivity gains.

Actions taken: Five modernisation priorities were chosen by the President: energy, IT, telecommunications, biotechnology and nuclear technology. Plans were announced to build an "innovation city" near Moscow with a special legal and tax regime. Immigration procedures for highly qualified foreign specialists were simplified.

Recommendations: Continue the reforms in the state science sector. Monitor and regularly review the outcomes of the special projects. Support private-sector innovation activities through universally applied fiscal incentives and legislative framework, avoiding "picking winners".

Other key priorities

Raise the quality of public administration

The inefficient and often corrupt practices on the part of government officials impose a significant burden on ordinary citizens and create obstacles for entrepreneurship and, ultimately, productivity gains.

Actions taken: A series of laws have been adopted within the framework of the Concept of Administrative Reform approved in 2005 and the anti-corruption initiative. A five-year programme of reform and development of the civil service was launched in 2009.

Recommendations: Continue with efforts to simplify regulations and procedures and reduce the bureaucratic interference in private sector activities. Reduce potential for corruption by minimising the need for subjective decision-making by bureaucrats.

Reform the health care system

Efforts to reform health care provision need to be stepped up to make significant progress in improving poor health outcomes, which harm productivity and wellbeing more broadly.

Actions taken: Some reforms have been undertaken within the framework of the National Priority Programme "Health" launched in 2005. The financing of the health care system has been increased and a range of measures to improve prevention are being put in place. A law was adopted in November 2010, reforming the framework for operation of the mandatory health insurance system.

Recommendations: Further increase public funding of health care and enhance the efficiency of the health care system. Focus prevention efforts on changing lifestyles. Encourage a shift from hospital to primary care. Improve the incentives for providers to deliver high-quality care.

RUSSIA

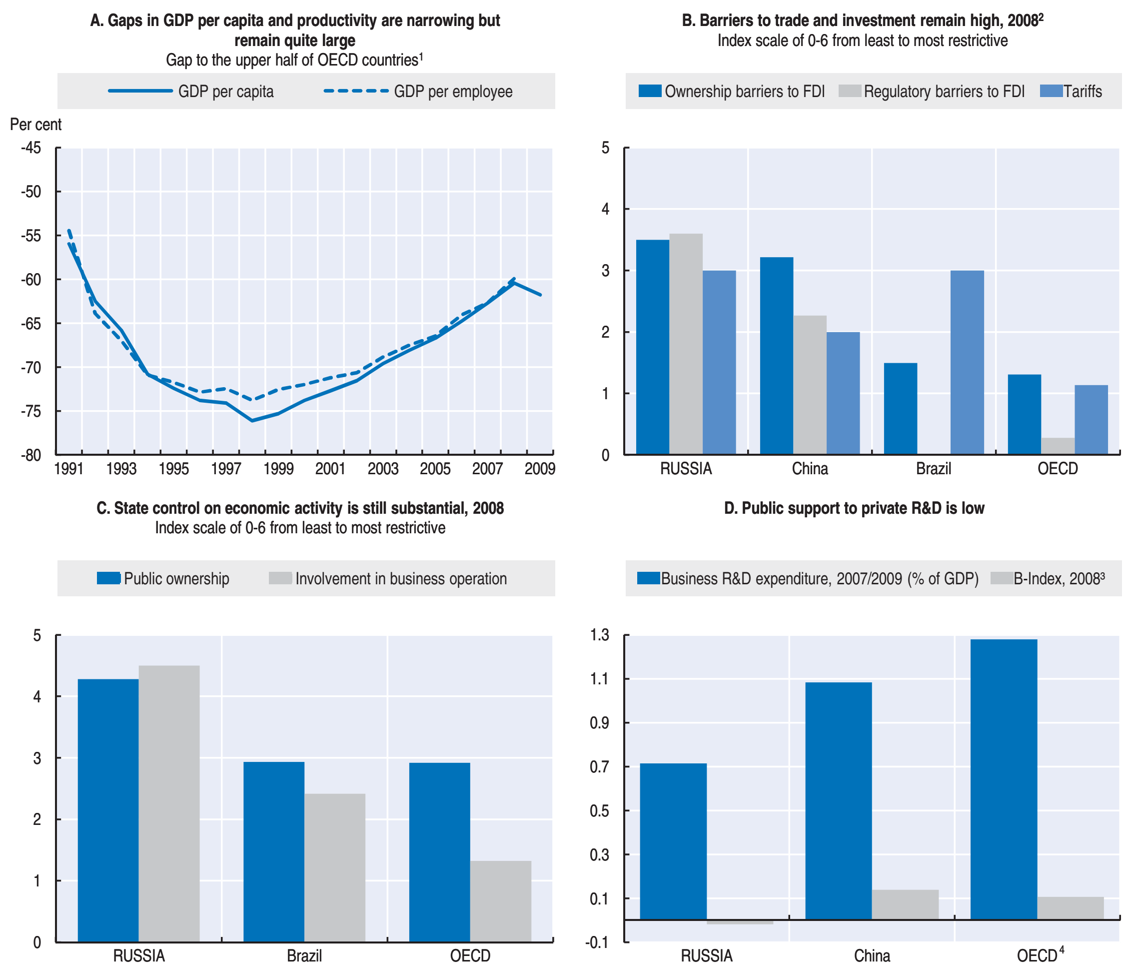
Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		7.3	7.0	7.5
Labour utilisation		..	..	..
of which:	Employment rate	1.6	2.1	1.1
	Average hours	..	..	..
Labour productivity[1]		5.6	4.9	6.3
of which:	Capital intensity	..	..	..
	Multifactor productivity	..	..	..

1. Labour productivity is measured as GDP per employee.

Source: Estimates based on World Bank (2010), *World Development Indicators (WDI)* and ILO (2010), *Key Indicators of the Labour Market (KILM) Databases*.



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per employee (in constant 2005 PPPs).
2. The FDI regulation index looks only at statutory restrictions and does not assess the manner in which they are implemented.
3. Measures the generosity of tax incentives to invest in R&D, on the basis of the pre-tax income necessary to cover the initial cost of one dollar R&D spending and pay corporate taxes on one dollar of profit (B-index). A value of zero on the chart would mean that the tax concession for R&D spending is just sufficient to offset the impact of the corporate tax rate. Average of small and medium enterprises and large firms.
4. Excluding Chile in the R&D expenditure and excluding Estonia and Slovenia in the B-Index.

Source: Chart A: World Bank (2010), *World Development Indicators* (WDI) and ILO (2010), *Key Indicators of the Labour Market (KILM) Databases*; Charts B and C: *Product Market Regulation Database*; Chart D: OECD, *Main Science and Technology Indicators Database*.

StatLink http://dx.doi.org/10.1787/888932374198

SLOVAK REPUBLIC

The rapid convergence in GDP per capita relative to the upper half of OECD countries observed since 2000 stopped in 2009 but productivity convergence continued. Substantial gaps in labour utilisation and productivity remain. The 2009 recovery plan introduced flexible work time accounts enabling firms to better adapt to the economic cycle. To improve longer-term economic performance further actions are needed in the following areas.

Priorities supported by indicators

Improve the funding and effectiveness of the education system

Tertiary educational attainment of younger cohorts remains low and international student test (PISA) scores are below the OECD average, hampering productivity.

Actions taken: Since 2009, the public funding of universities relies more on output indicators.

Recommendations: Reduce stratification of the education system and foster integration of Roma children in the education mainstream. Make tertiary education more attractive by offering occupationally-oriented programmes. Introduce tuition fees combined with income-contingent repayment loans for all tertiary students.

Reduce regulatory barriers to competition

Substantial impediments to competition remain in network sectors and liberal professions, limiting productivity growth.

Actions taken: The government finalised the second phase of an action plan for assessing administrative burdens on business and barriers to entry in 2009.

Recommendations: Reduce administrative burdens on firms, strengthen competition in the telecommunications and energy sectors by resuming the privatisation process, and abolish compulsory chamber membership for liberal professions while maintaining required standards of professional qualification.

Reduce barriers to female labour force participation

Employment rates are very low for mothers, in particular those with young children, and for older women.

Actions taken: The statutory retirement age for women is being gradually raised and should reach 62 by 2014. Childcare subsidies have been reformed to allow parents to receive the benefit while working (from January 2011).

Recommendations: Shorten the duration of parental leave benefit entitlements in favour of childcare subsidies and further remove fiscal disincentives to work for second earners.

Other key priorities

Strengthen policies to promote labour mobility

The labour market is characterised by a high share of long-term unemployed in total unemployment and by low labour market mobility.

Actions taken: A portion of state funds which were previously used to support construction of owner-occupied housing has been diverted to rental housing projects in 2009 and 2010.

Recommendations: Expand training measures, strengthen the capacity of the public employment service, narrow the targeting of subsidised job creation, remove obstacles to the expansion of a private rental market, and improve the targeting of housing subsidies.

Improve the innovation support framework

R&D expenditures are low compared to the OECD average and decreasing in the business sector, limiting innovation activity.

Actions taken: The government introduced new public subsidies and tax relief to foster business R&D in 2009 and plans to support highly innovative firms by providing "risk capital" as returnable financial aid.

Recommendations: Create incentives to innovate by improving the business environment, reducing the administrative burden on start-ups, and facilitating access to venture capital. Strengthen the quality of public institutions involved in R&D funding. Foster the diffusion of information by encouraging collaboration between the public and private institutions in R&D, developing knowledge networks and facilitating access to ICT.

SLOVAK REPUBLIC

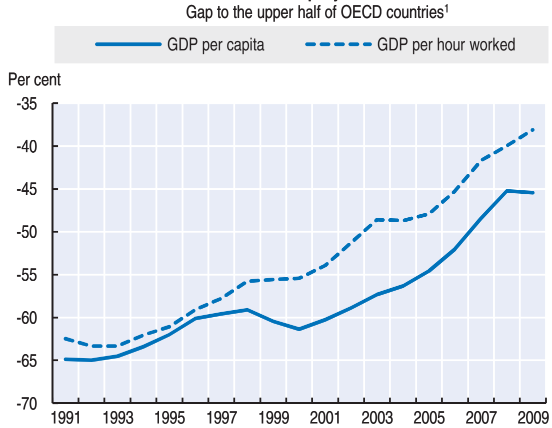
Structural indicators

Average annual trend growth rates, per cent

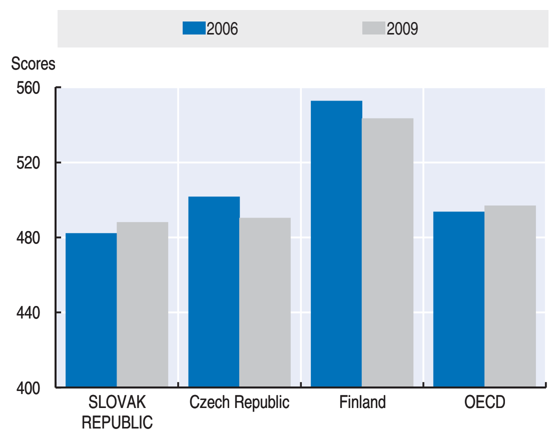
		1999-2009	1999-2004	2004-09
GDP per capita		4.9	4.5	5.3
Labour utilisation		0.6	0.0	1.2
of which:	Employment rate	1.0	0.5	1.5
	Average hours	–0.4	–0.5	–0.3
Labour productivity		4.3	4.5	4.0
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database*.

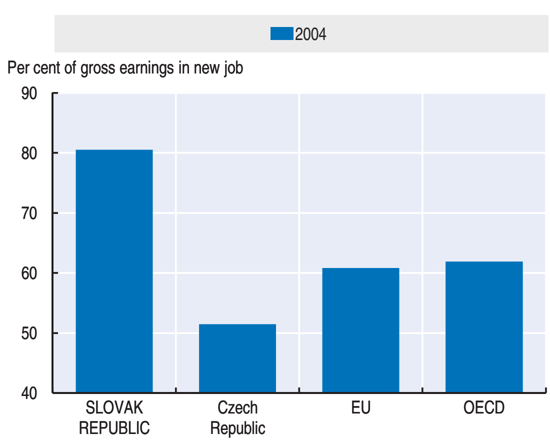
A. Gaps in GDP per capita and productivity have been narrowing rapidly
Gap to the upper half of OECD countries[1]



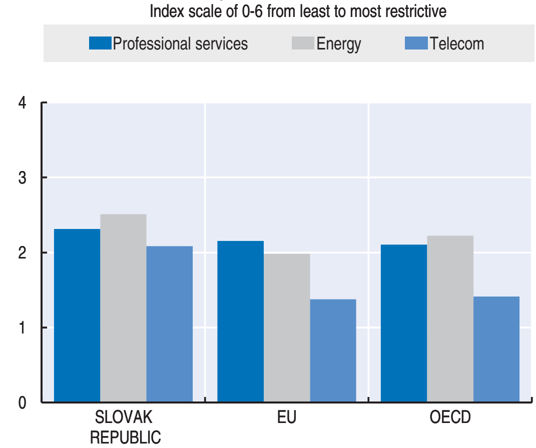
B. Student performance remains low
Average of PISA scores in mathematics, science and reading



C. The implicit tax on returning to work is high for second earners[2]



D. Barriers to competition could be reduced in network industries and professional services, 2008
Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Taking into account childcare fees and changes of taxes and benefits in case of a transition to a job paying two-thirds of average worker earnings.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *PISA 2009 Database*; Chart C: OECD (2004), *Benefits and Wages: OECD Indicators*; Chart D: OECD, *Product Market Regulation Database*.

StatLink http://dx.doi.org/10.1787/888932374217

SLOVENIA

The income gap relative to the upper half of OECD countries narrowed significantly prior to the crisis, before starting to widen again. This gap is largely explained by a shortfall in labour productivity. The recent introduction of a one-stop shop for companies to reduce the burden of setting up a business, as well as personal and corporate income tax reforms, should boost performance. Further reforms are still needed in the areas below.

Priorities supported by indicators

Reduce state involvement in the economy

High market concentration and heavy state involvement in the business operations of major firms through widespread asset holdings are pervasive across network industries and the financial sector, hampering FDI inflows and productivity growth.

Actions taken: Some privatisation has been undertaken, particularly in the retail food and banking sectors. The two State funds significantly reduced the number of companies in their portfolios, though the State increased its ownership share in strategic firms. Parliament adopted legislation in 2010 establishing a central ownership agency to manage State assets.

Recommendations: Facilitate new entry by reducing state ownership in network industries. Boost competition in the electricity sector by removing existing restrictions on distributors to buy electricity from different sources rather than from the cheapest source. Ensure that the appointment of supervisory and management boards of the firms in which the State holds a stake is transparent and based on merit. Devise a rigorous and transparent regime for determining which State assets should remain in public hands and set up a new privatisation plan.

Ease employment protection legislation

Employment protection legislation for regular contracts is overly restrictive, creating a dual labour market.

Actions taken: In October 2010, Parliament adopted a "mini jobs" bill, which allows students, pensioners and the unemployed to work limited hours in low-pay, more flexible jobs. Severance pay has been reduced to one-fifth of the average salary in the last three months of employment for all workers.

Recommendations: Further reduce notice periods and administrative burdens on individual dismissals and relax the conditions under which individual dismissals are legitimate.

Raise the statutory retirement age and reduce disincentives to work at older ages

The low statutory retirement age and a poorly designed pension system unduly reduce the labour supply of older workers.

Actions taken: The government presented to Parliament in October 2010 a new draft legislation that seeks to increase the retirement age, extend contributory period requirements and reduce the generosity of pension benefits.

Recommendations: Increase the statutory retirement age and limit access to early retirement. Introduce greater financial incentives to deferred retirement. Give more weight to inflation in the pension benefit indexation formula.

Other key priorities

Improve tertiary educational outcomes

Despite some progress, tertiary graduation rates remain low, undermining human capital formation and productivity.

Actions taken: No action taken.

Recommendations: Tie access to student benefits to adequate progress in studies. Introduce and develop tuition fees in public institutions, along with student loans with income-contingent repayments, in order to encourage completion and provide higher education institutions with adequate funding while maintaining equitable access.

Reform wage bargaining

The minimum wage and public sector wages are indexed to the average wage in the manufacturing sector and growth in private sector wages, respectively. As a result, wage bargaining is insufficiently tied to overall economic conditions.

Actions taken: The minimum wage was increased by 23% in early 2010 to be implemented by 2012.

Recommendations: Abolish the indexation of public sector wages and ensure the minimum wage is indexed to inflation for a while.

SLOVENIA

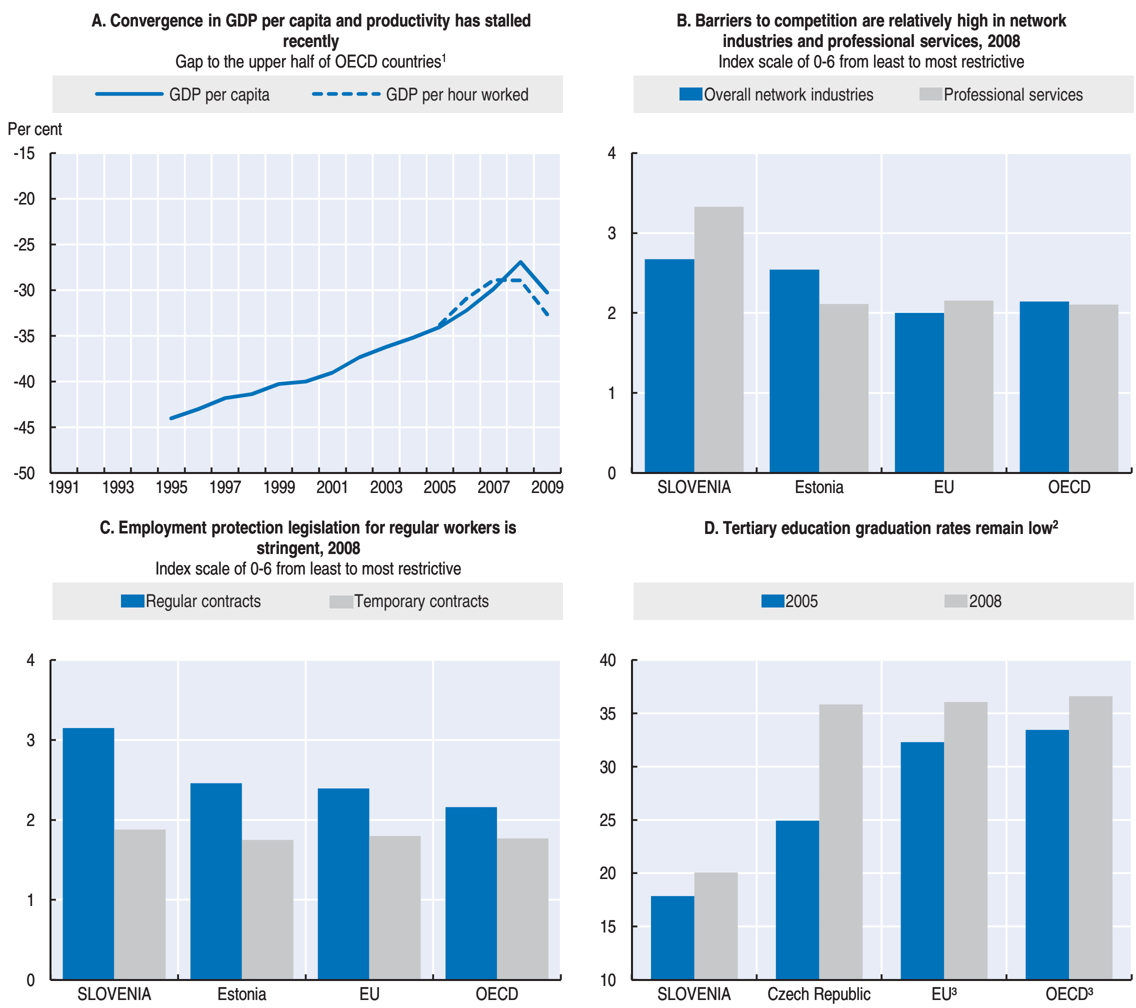
Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		3.1	4.1	2.2
Labour utilisation		. .	. .	. .
of which:	Employment rate	0.4	0.7	0.0
	Average hours	. .	. .	. .
Labour productivity[1]		2.7	3.3	2.2
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

1. Labour productivity is measured as GDP per employee.

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. First-time graduation rates for single year of age at tertiary-type A level.
3. Average of European countries in the OECD. EU and OECD averages exclude Belgium, Chile, Estonia, France and Korea.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; No. Chart B: OECD, *Product Market Regulation Database*; Chart C: *Employment Database*; Chart D: OECD (2010), *Education at a Glance.*

StatLink http://dx.doi.org/10.1787/888932374236

SOUTH AFRICA

The GDP per capita gap with the upper half of OECD countries has failed to narrow since the transition to majority rule, although there has been some convergence in the last few years. Compared with other non-OECD countries, an unusually large part of the gap is explained by low labour utilisation. A large expansion of social grants has been important in alleviating poverty, but structural reforms would help speed up convergence to OECD income levels.

Priorities supported by indicators

Raise the quality of education and reduce inequalities in attainment

Enrolment in primary and secondary education has been greatly increased, but educational attainment is poor on average with extremely high dispersion, which hampers human capital formation and productivity.

Actions taken: The child support grant has been extended to 18, helping keep older children in school.

Recommendations: Improve teacher training, and introduce effective measures to deal with chronically ineffective teachers. Phase out school fees. Improve the provision of textbooks and reading materials, and upgrade school infrastructure.

Enhance competition in network industries

South Africa's network industries are dominated by state-owned firms, with legal barriers to entry in some cases and inbuilt advantage for the near-monopoly incumbents. As a result, product market regulation in energy, transport and communications is more restrictive than in almost all OECD countries, hampering productivity.

Actions taken: The government has proposed separating the generation and distribution activities of Eskom, the state-owned electricity utility.

Recommendations: Remove legal barriers to entry in network industries. End the possibility of granting state-owned enterprises exemptions to competition laws. Move towards separating generation, transmission and distribution of electricity. Strengthen the independence and resources of the telecoms regulator. Unbundle the different divisions of the transport parastatal Transnet and move towards privatisation of the separate units where feasible.

Reform the wage bargaining system

There is a relatively high degree of coordination in wage bargaining, which tends to be associated with poor employment outcomes, and administrative extension of collective bargaining within sectors depresses competition and employment.

Actions taken: No action taken.

Recommendations: Weaken administrative extension of collective bargains in sectors covered by bargaining councils. Provide for indicative guidelines for wage bargains at a centralised level, with government playing a role to ensure that such guidelines are consistent with inflation targets and thus do not undermine the employment prospects of labour market outsiders.

Other key priorities

Strengthen policies to tackle youth unemployment

Unemployment rates for the 15-24 age group approach 50% overall, and exceed that threshold for the black African population, reflecting a number of factors, including labour market policy weaknesses.

Actions taken: Public works programmes were expanded in 2009 as a short-term measure to mitigate unemployment. The 2010 Budget Review proposed a wage subsidy for young and/or inexperienced workers.

Recommendations: Provide for age-differentiation of minimum wages in sectors where these are set by the state. Implement a wage subsidy, possibly via an expansion of the learnership programme. Intensify placement assistance.

Reduce barriers to entrepreneurship

Product market regulation is relatively restrictive, including with respect to the burden of licenses and permits and the complexity of rules and procedures.

Actions taken: A pilot project was approved to test a Regulatory Impact Assessment (RIA) instrument.

Recommendations: Introduce systematic RIA for all new regulation, and review existing legislation with a view to reducing administrative burdens.

SOUTH AFRICA

Structural indicators

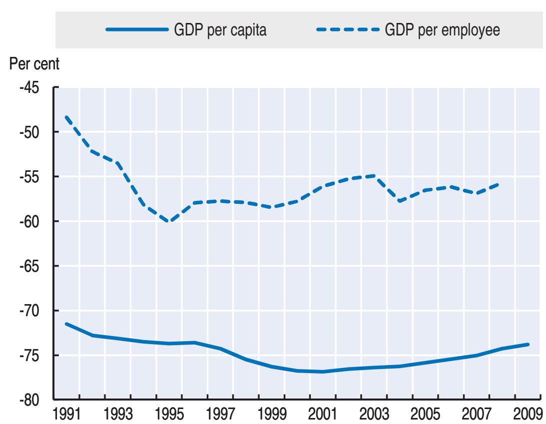
Average annual trend growth rates, per cent

		1998-2008	1998-2003	2003-08
GDP per capita		2.5	1.2	3.7
Labour utilisation		. .	. .	. .
of which:	Employment rate	0.7	–1.5	3.0
	Average hours	. .	. .	. .
Labour productivity[1]		1.7	2.7	0.7
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

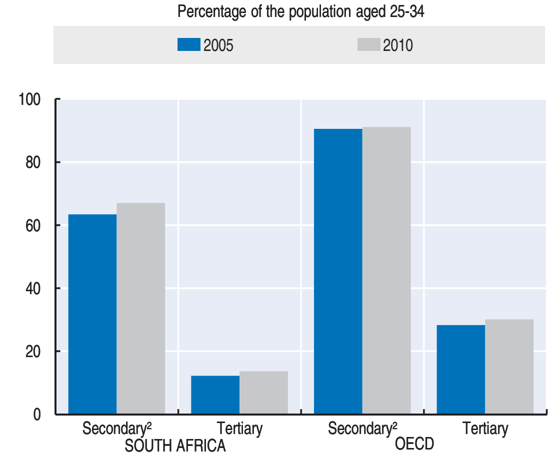
1. Labour productivity is measured as GDP per employee.

Source: Estimates based on World Bank (2010), *World Development Indicators (WDI)* and ILO (2010), *Key Indicators of the Labour Market (KILM) Databases.*

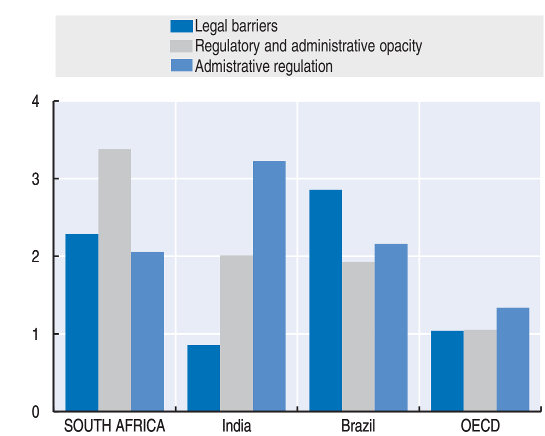
A. Gaps in GDP per capita and productivity are large and persistent
Gap to the upper half of OECD countries[1]



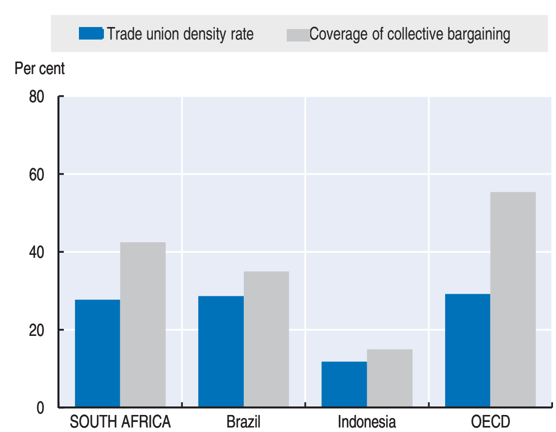
B. Secondary and tertiary educational attainment remains relatively low
Percentage of the population aged 25-34



C. Barriers to entrepreneurship are high, 2008
Index scale of 0-6 from least to most restrictive



D. Extension of collective bargaining needs to be eased, 2007/2008



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per employee (in constant 2005 PPPs).
2. Secondary educational attainment measures the share of the population aged 25-34 that has reached at least lower-secondary education.

Source: Chart A: World Bank (2010), *World Development Indicators* (WDI) and ILO (2010), *Key Indicators of the Labour Market (KILM) Databases*; Chart B: Samir *et al.* (2008), "Projection of Population by Level of Education Attainment, Age and Sex for 120 countries for 2005-2050", International Institute for Applied Systems Analysis Interim Reports; Chart C: *Product Market Regulation Database*; Chart D: *OECD employment Outlook and J. Visser, Database,* Amsterdam Institute for Advanced Labour Studies (2010), *ICTWSS Database* 3.1.

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SPAIN

Convergence in GDP per capita has stalled, although performance compares more favourably on the basis of current international prices. Productivity growth has increased recently, in part reflecting the downsizing of residential construction, where productivity is low, whereas labour utilisation has dropped. In the housing market, enforcement of rental contracts has improved and the tax treatment of rental and owner-occupied housing has been equalised. Progress has been made notably in the labour market area, but further reforms are needed in the following fields.

Priorities supported by indicators

Improve educational attainment in secondary education

The high school drop-out rate in lower secondary education limits pupils' labour-market prospects.

Actions taken: The government has proposed nation-wide testing of all pupils and has taken steps to facilitate the transition of academically-weak pupils from lower secondary to vocational upper secondary education. Draft legislation has been presented to parliament to adapt vocational schools' curricula to local businesses' needs and improve access of graduates to tertiary education.

Recommendations: Minimise grade repetition, including by linking the conditions for moving to higher grades more closely to core competencies. Strengthen hiring autonomy of schools with respect to hiring decisions. Evaluate vocational schools with respect to labour market outcomes of graduates and publish results.

Make wages more responsive to economic and firm-specific conditions

Wage agreements are insufficiently tailored to firm-specific conditions, raising unemployment especially in periods of economic slack.

Actions taken: The 2010 labour market reform substantially eases the conditions for firms to opt out from higher-level collective bargaining agreements.

Recommendations: Abolish the legal extension of collective wage agreements. Simplify the system of collective bargaining, giving more room for wages and other work conditions to be decided at the firm level.

Ease employment protection legislation for permanent workers

The severance pay for workers on permanent contracts is high, resulting in excessive use of temporary contracts with adverse effects on productivity and unemployment for certain population groups.

Actions taken: The 2010 labour market reform is expected to make it easier for firms to have dismissals accepted as justified, potentially reducing dismissal costs significantly. The reform also facilitates the use of permanent contracts with reduced severance pay. From 2012, employers will pay a yet to be specified part of the dismissal compensation into a fund from which the workers will be able to draw upon dismissal, retirement, training or mobility purposes. The government reform tightens the use of temporary contracts progressively between 2012 and 2015.

Recommendations: Reduce severance pay further for all new permanent contracts. Consider introducing a single contract with initially low, but moderately increasing severance payments linked to job tenure.

Other key priorities

Reduce the disincentives for older workers to continue working

High implicit tax rates on continued work contribute to a low effective retirement age. This lowers labour supply especially at a time when demographic ageing sets in.

Actions taken: After the end of the GfG priority identification process, the government and the social partners have reached an agreement on a pension reform proposal, which includes an increase of the legal retirement age from 65 to 67 years for workers with contribution records of less than 38.5 years and some lengthening of the contribution periods required for a full pension.

Recommendations: Further lengthen the contribution periods required for a full pension. Index the retirement age or other parameters to increases in life expectancy. Reduce the duration of extended unemployment benefits paid to workers before they receive an old-age pension. Abolish subsidies to partial retirement.

Ease regulation of retail outlets

Restrictive regulation of large retail outlets limits firm entry and competition in the retail trade sector.

Actions taken: The national license requirement for large surface outlets was abolished in 2010, but regional governments may still require an authorisation under overriding reasons related to public interest. The transposition of the EU services directive outlaws the use of economic criteria for licensing requirements.

Recommendations: Lower remaining regional barriers for the establishment of large-surface retail outlets.

SPAIN

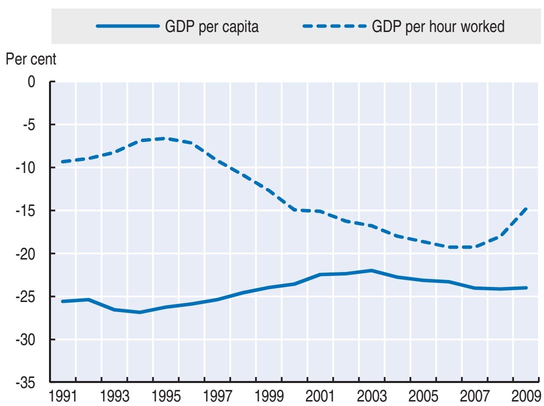
Structural indicators

Average annual trend growth rates, per cent

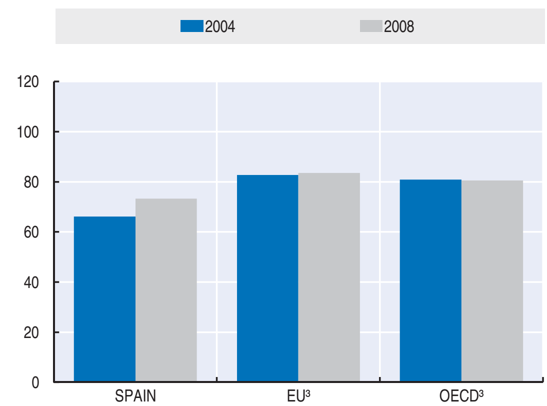
		1999-2009	1999-2004	2004-09
GDP per capita		1.8	2.3	1.2
Labour utilisation		0.9	1.7	0.1
of which:	Employment rate	1.3	2.1	0.5
	Average hours	–0.4	–0.4	–0.4
Labour productivity		0.9	0.6	1.1
of which:	Capital intensity	1.2	1.0	1.3
	Multifactor productivity	–0.3	–0.4	–0.2

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

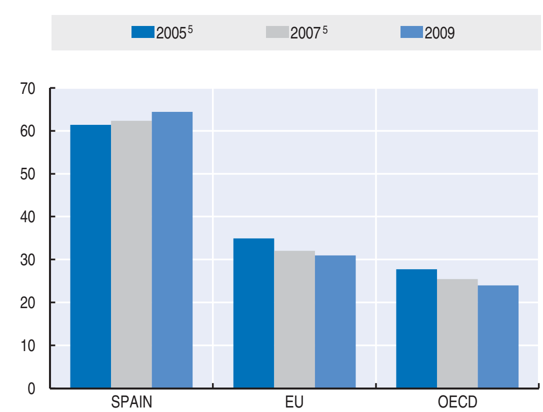
A. Gaps in GDP per capita and productivity are persistent
Gap to the upper half of OECD countries[1]



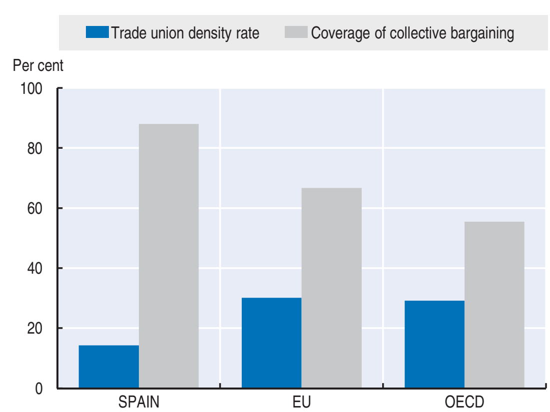
B. Upper secondary school graduation rates could be further enhanced[2]



C. Implicit taxes on continued work are very high[4]
Percentage of average worker earnings



D. The exess coverage of collective bargaining should be reduced



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. First-time graduation rates for single year of age at upper secondary level.
3. Average of European countries in the OECD. EU and OECD exclude Australia, Austria, Belgium, Estonia, France and the Netherlands.
4. Implicit tax on continued work in early retirement route, for 55 and 60-year-olds.
5. Average of European countries in the OECD. EU and OECD exclude Chile, Estonia, Israel and Slovenia.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD (2010), *Education at a Glance*; Chart C: Duval, R. (2003), "The Retirement Effects of Old-Age Pension and Early Retirement Schemes in OECD Countries", *OECD Economics Department Working Papers*, No. 370 and OECD calculations; Chart D. *Employment Outlook Database*.

StatLink http://dx.doi.org/10.1787/888932374274

SWEDEN

The income gap vis-à-vis leading OECD economies has widened somewhat in recent years, reflecting a productivity slowdown. Employment rates are high, but average hours worked are low. Reforms of the benefit dependency scheme and labour taxation have helped support labour force participation and employment, and efforts to mitigate greenhouse gas emissions have been made. Further reforms are required, in the areas below.

Priorities supported by indicators

Reform sickness and disability benefit schemes

Sickness absence and disability benefits have been high and conditions to access to these benefits have long been lax compared to other OECD economies, reducing labour force participation.

Actions taken: Tighter administration, time limits on eligibility and measures to promote rehabilitation have lowered sickness absence rates. Temporary disability benefits are in the process of being phased out in 2010.

Recommendations: Continue the reforms to improve gate-keeping to sickness and disability benefits.

Ease restrictive employment protection legislation

Employment protection rules governing individual dismissal for regular contracts are strict compared to other OECD economies, including the other Nordics, even though negotiations with social partners and temporary contracts provide some flexibility. This raises employment costs, reduces flexibility and contributes to create a dual labour market.

Actions taken: No significant action has been taken on regular contracts.

Recommendations: Reduce job protection on regular contracts by, for instance, easing procedures for dismissals.

Reduce marginal taxes on labour income

Average hours worked are low compared to a number of OECD economies, in part owing to high marginal tax rates for earnings above average levels.

Actions taken: The lower threshold for the state income tax was raised in 2009 and the in-work tax credit was expanded in 2009 and 2010.

Recommendations: Cut income taxes by further raising the threshold for the state income tax or reducing its rate. In parallel, shift some of the tax burden towards property and consumption taxes, notably by broadening the consumption tax base.

Other key priorities

Reduce housing market distortions

Private rent controls are amongst the strictest among OECD countries, hindering the efficiency of this market.

Actions taken: Outright ownership of owner-occupied apartments was introduced for new apartment buildings in 2009. New regulations, entering into force in 2011, require municipal housing companies to follow market principles.

Recommendations: Continue to reduce rent regulation. Reverse the housing taxation cut implemented in 2007.

Improve the efficiency and quality of the education system

The age of graduation from university is high and based on international student test (PISA) scores there is room for improving learning outcomes at secondary school.

Actions taken: University tuition fees will be introduced for students outside the European Economic Area in 2011. In tertiary education, financial support for students has been increased and places in the regular system have been temporarily expanded. Admission criteria have been reformed to encourage direct transition from upper secondary to tertiary education.

Recommendations: Strengthen compulsory schooling, especially in science, and improve vocational education opportunities through better workplace links. Introduce fees and other financial incentives to speed up completion of tertiary education and improve market signals for universities.

SWEDEN

Structural indicators

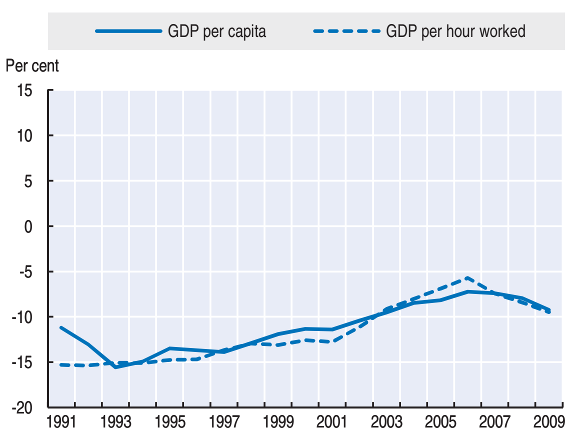
Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		2.3	2.4	2.1
Labour utilisation		0.1	0.0	0.2
of which:	Employment rate	0.2	0.2	0.2
	Average hours	–0.2	–0.3	–0.1
Labour productivity		2.2	2.5	2.0
of which:	Capital intensity	1.0	1.2	0.9
	Multifactor productivity	1.2	1.3	1.1

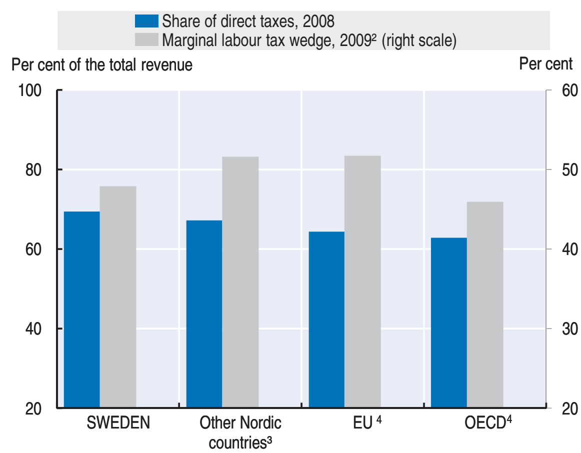
Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

A. Gaps in GDP per capita and productivity linger

Gap to the upper half of OECD countries[1]

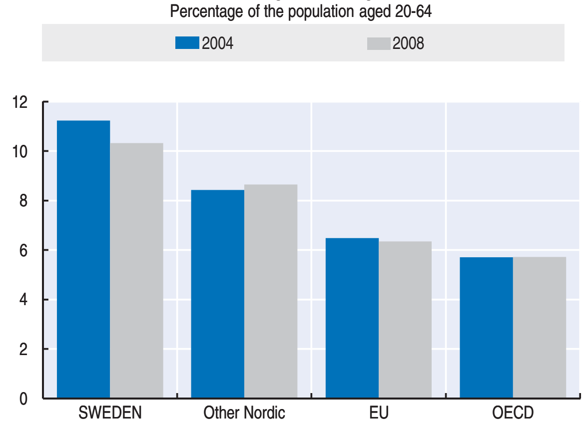


B. The marginal tax wedge on labour income remains slightly above the OECD average



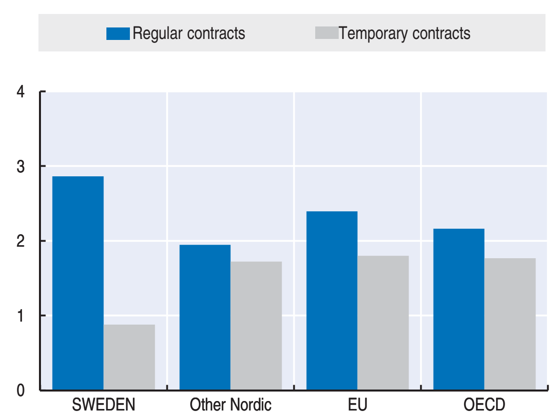
C. The share of working-age population receiving disability benefits is one of the highest amoung OECD countries

Percentage of the population aged 20-64



D. Employment protection legislation is unbalanced, 2008

Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Evaluated at 100% of average earnings for a single person with no child. Percentage of total labour compensation.
3. Average of Denmark, Finland and Norway.
4. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *Taxing Wages and Tax Databases*; Chart C: OECD (2010), *Sickness, Disability and Work: Breaking the Barriers: A Synthesis of Findings across OECD Countries*; Chart D: OECD, *Employment Database*.

StatLink http://dx.doi.org/10.1787/888932374293

SWITZERLAND

The decline in real GDP per capita vis-á-vis the best performing OECD countries has stopped due to a relative increase in labour utilisation while the gap in productivity remains. Actions have been taken in several areas, notably regarding the prudential supervision of systemically important banks, including through stricter capital and liquidity requirements. Reforms in the following areas are still needed to improve trend economic growth.

Priorities supported by indicators

Remove barriers to competition in network industries

Anti-competitive regulation hinders entry and generates insufficient incentive to reduce costs, hence contributes to modest productivity performance.

Actions taken: Draft legislation aims at further reducing the scope of the legal monopoly in postal services and at introducing price cap regulation in services remaining subject to the legal monopoly. It is planned to further improve access of competitors to the rail infrastructure.

Recommendations: Strengthen the regulator's powers, strengthen vertical separation and introduce benchmark regulation in the electricity sector. Remove legal restrictions on competitors' access to the incumbent's local loop in telecommunications. Sell remaining government stakes in electricity generation, and telecommunications. Privatise the incumbent postal services provider.

Reduce producer support to agriculture

High subsidies and import protection of agricultural goods generate high costs to taxpayers and distort prices.

Actions taken: Milk production quotas have been abolished.

Recommendations: Further lower the border protection of domestic production. Remove impediments to shifting agricultural land to other use. Accelerate the replacement of subsidies by direct income support and tie support to individual incumbent farmers to avoid biasing inheritance decisions. Eliminate collusion among producers.

Facilitate full-time labour force participation for women

Limited access to pre-school facilities and unfavourable second earner income taxation reduce work incentives for women.

Actions taken: The central government will continue to co-fund childcare facilities until 2014. Parliament has approved a tax allowance for child care expenses. Many cantons have agreed to start compulsory schooling at four years.

Recommendations: Introduce a nation-wide voucher scheme to subsidise childcare services. Move from joint to individual tax assessment of each spouse's income.

Other key priorities

Increase the efficiency of the health system

Health care spending per capita is among the highest in the OECD, especially in hospital care, even in comparison with countries with similarly high health outcomes.

Actions taken: Hospital funding based on diagnosis-related groups will be introduced by 2012. The government will implement measures to reduce medication-related health insurance costs.

Recommendations: Abandon the mixed hospital funding and make insurers responsible for all hospital funding. Allow insurers more freedom to contract with individual providers, and widen the extent to which insurers are compensated for differences in risk characteristics.

Improve access to tertiary education

Few government-sponsored loans are available to finance tertiary studies, limiting access, especially in tertiary vocational education where study fees are high. Early tracking lowers opportunities for some pupils with high competency levels but low socio-economic background to obtain access to tertiary academic education.

Actions taken: A new law coordinates the policy of the Confederation and the cantons towards tertiary academic education and adopts best practice in accreditation and quality assurance. Most cantons have agreed to postpone tracking of pupils to age 13.

Recommendations: Make government sponsored loans to students widely available, coupled with an income-contingent repayment scheme, but raise fees in tertiary academic education. Review the mix of vocational and academic education content within upper secondary vocational tracks. Postpone tracking to at least 13 years.

SWITZERLAND

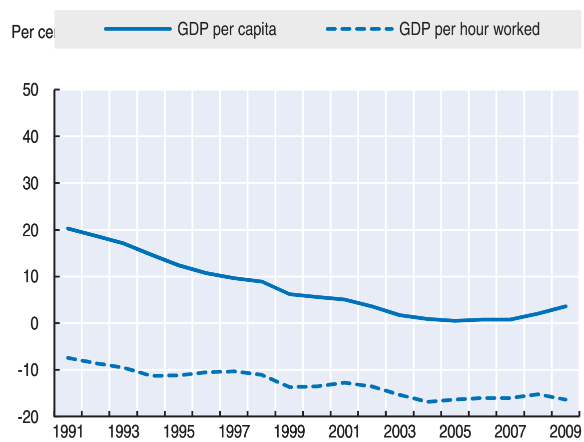
Structural indicators

Average annual trend growth rates, per cent

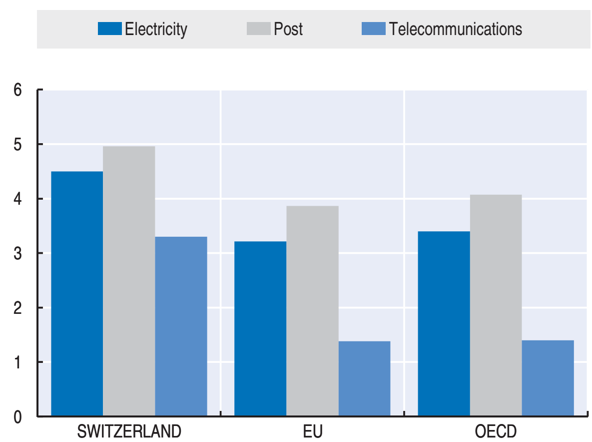
		1999-2009	1999-2004	2004-09
GDP per capita		1.1	1.2	1.0
Labour utilisation		0.1	0.0	0.3
of which:	Employment rate	0.3	0.2	0.4
	Average hours	–0.2	–0.2	–0.1
Labour productivity		1.0	1.2	0.8
of which:	Capital intensity	0.6	0.8	0.5
	Multifactor productivity	0.4	0.4	0.3

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database*.

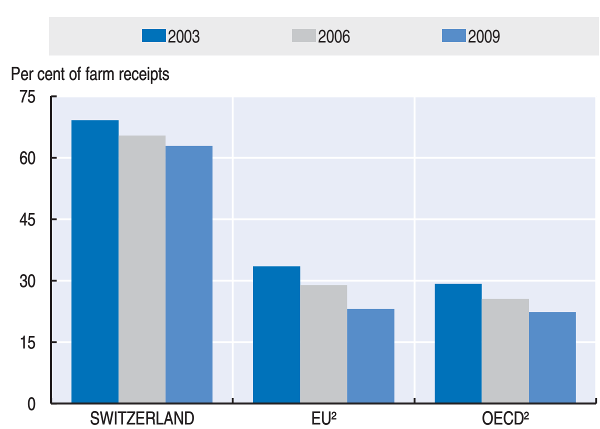
A. A productivity gap persits
Gap to the upper half of OECD countries[1]



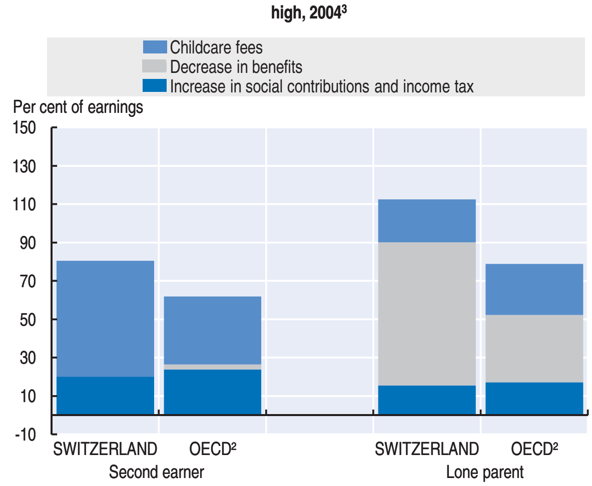
B. Public ownership in network industries remains high, 2008
Index scale of 0-6 from least to most restrictive



C. Agricultural support remains very high



D. Disincentives to full-time work for women with children are high, 2004[3]



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.
3. Based on implicit tax on returning to work, defined as the cost of childcare, reductions in income-related benefits and increases in social contributions and personal income taxes, all relative to earnings in the new job. Measured for second earners and for lone parent with income equal to two-thirds of average earnings.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *Product Market Regulation Database*; Chart C: OECD, *Producer and Consumer Support Estimates Database*; Chart D: OECD (2004), *Benefits and Wages: OECD Indicators*.

StatLink http://dx.doi.org/10.1787/888932374312

TURKEY

The income gap vis-à-vis *the upper half of OECD countries narrowed in the 2000s but remains very large, reflecting both low labour productivity and utilisation levels. Strong catch-up until the 2009 crisis reflected mainly productivity gains, while labour utilisation remained very low. A new draft Commercial Code has been prepared and should be adopted to improve financial transparency and facilitate financing investment. Structural reforms in the areas below are needed to improve overall economic performances.*

Priorities supported by indicators

Reduce the minimum cost of labour

A high minimum wage relative to the average wage and high social security contributions keep labour costs very high for low-skilled workers. This discourages employment in the formal sector, in particular in regions where activity and living costs are low.

Actions taken: The *Employment Package* introduced in late 2008 reduced tax wedges for all workers and, in a higher proportion but temporarily, for young and female workers. Additional reductions were granted in selected provinces and for all new hires across Turkey at the end of 2009 as part of the crisis response.

Recommendations: Limit the growth of official minimum wages and differentiate them across regions. Continue reducing social security contributions and make these cuts permanent. Reduce pension benefits in actuarially neutral terms and top them up with a voluntary savings scheme into which the difference would be paid between the employees [ldquoe]current (high) and future (low) social security taxes.

Improve educational achievement

The average academic performance in secondary education and enrolment rates in tertiary education remain low in international comparison. The lack of basic skills for a large share of the population results in low productivity.

Actions taken: No new action taken, although previously-introduced curriculum reforms in primary and secondary education continue to be implemented.

Recommendations: Increase the availability of high quality education and finance this by broadening the tax base. Fund schools on a per-pupil basis and give them greater managerial responsibility and accountability. New universities should be adequately funded.

Reform employment protection legislation

Employment protection is rigid for both permanent and – especially – temporary workers, contributing to maintaining resources in inefficient informal and semi-formal activities.

Actions taken: No action taken. The government announced in 2010 that a new National Employment Strategy will be introduced.

Recommendations: Ease employment protection by reducing severance pay costs and liberalise temporary work and temporary work agencies. Allow more flexible forms of labour contracts on a voluntary basis.

Other key priorities

Simplify product market regulation

Product market conditions, in particular sectoral licensing rules and state ownership in large network industries, hinder competition and productivity in the formal sector.

Actions taken: The Co-ordination Council for the Improvement of the Investment Environment (YOIKK) started simplifying licensing rules. Privatisations in electricity distribution have resumed.

Recommendations: Pursue the simplification of licensing rules and advance privatisations.

Reduce incentives for early retirement

Incentives for early retirement from the formal sector encourage taking up work in the informal sector.

Actions taken: No action taken.

Recommendation: Make benefits more actuarially neutral and establish a health insurance contribution for young retirees.

TURKEY

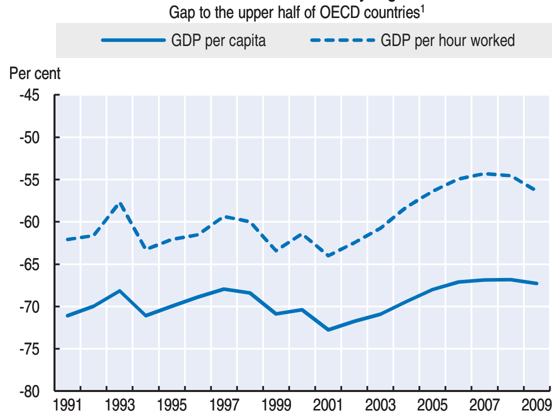
Structural indicators

Average annual trend growth rates, per cent

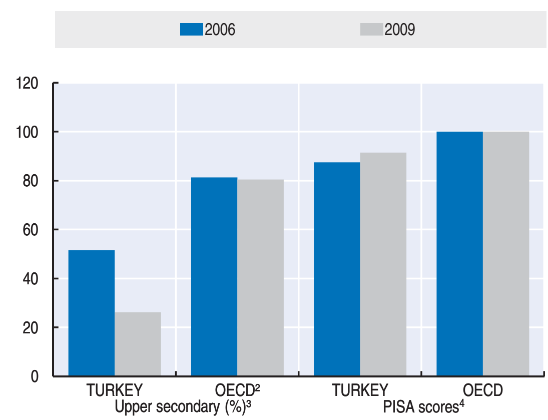
		1999-2009	1999-2004	2004-09
GDP per capita		3.0	2.7	3.3
Labour utilisation		0.2	–0.2	0.6
of which:	Employment rate	0.1	–0.4	0.6
	Average hours	0.1	0.1	0.0
Labour productivity		2.8	2.9	2.7
of which:	Capital intensity	. .	. .	. .
	Multifactor productivity	. .	. .	. .

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*

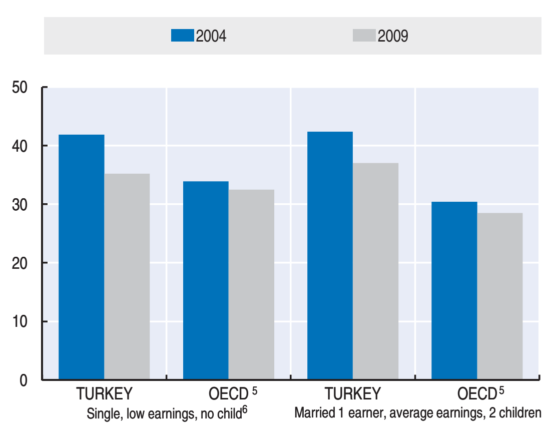
A. Gaps in GDP per capita and productivity have narrowed somewhat but remain very large
Gap to the upper half of OECD countries[1]



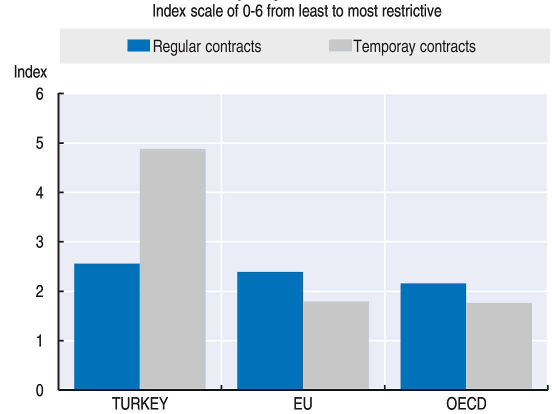
B. Secondary school graduation and achievement are lagging



C. The average tax wedge on labour income remains high
Percentage of total labour compensation



D. Employment protection legislation is stringent, especially for temporary workers, 2008
Index scale of 0-6 from least to most restrictive



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Average of OECD countries excluding Australia, Austria, Belgium, Estonia, France and the Netherlands.
3. First-time graduation rates for single year of age at upper secondary level, years 2006 and 2008.
4. Average score of student performance in mathematics, science and reading. Index OECD = 100.
5. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.
6. Low earnings refer to two-thirds of average earnings.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD (2010), *Education at a Glance; OECD, PISA 2009 Database*; Chart C: OECD, *Taxing Wages Database*; Chart D: OECD, *Employment Database*.

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UNITED KINGDOM

Relative employment rates remain slightly below the average of the upper half of OECD countries and have slipped somewhat during the last few years. Labour productivity has converged to some extent but is still below average, leaving a significant gap in GDP per capita. Government spending on R&D has increased recently, but more needs to be done in the following areas to improve living standards further.

Priorities supported by indicators

Improve the educational achievement of young people

Educational outcomes, measured by international student test (PISA) scores show that student performance is uneven, with sizeable shares of the student population performing badly. Secondary school completion rates are low and youth unemployment is high.

Actions taken: The previous government introduced a number of schemes to improve standards of literacy and numeracy. The current government is introducing a pupil premium for disadvantaged students. It also plans to raise the secondary school leaving age to 18 years by 2015.

Recommendations: Continue the focus on core literacy and numeracy skills. Increase further the resources for disadvantaged students and improve targeting mechanisms. Encourage participation in secondary education by reintroducing the Education Maintenance Allowance. Ensure that vocational programmes provide skills that are relevant for the labour market

Improve public infrastructure, especially in transport

Low investment in public infrastructure has contributed to congestion, especially in road transport and airports, hampering productivity.

Actions taken: Investment in infrastructure has been increased substantially in recent years, partly as a consequence of bringing forward investment during the recession. However, investment remains low compared with other OECD countries and current plans envisage a sharp fall in spending after 2010.

Recommendations: Free up more resources in other spending areas within current spending plans to mitigate cuts in infrastructure investment. Implement a national road pricing scheme to mitigate road congestion.

Further reform disability benefit schemes

The share of the working age population that receives disability benefits remains high compared to the OECD average, although it has fallen slightly recently.

Actions taken: The Pathways to Work scheme now applies to all new and most existing claimants under 50. A new eligibility test has been introduced.

Recommendations: Extend the Pathways to Work scheme to all existing claimants. Monitor health status of applicants earlier than the mandatory 13 weeks.

Other key priorities

Strengthen public sector efficiency

Productivity in the public sector has fallen over the last decade, revealing a need for efficiency improvements.

Actions taken: The previous government introduced a number of reforms of the National Health Service (NHS) to improve efficiency, but their effectiveness remains unclear. The current government has decided to start pilot schemes to decentralise responsibilities for purchasing hospital care to General Practitioners (GPs).

Recommendations: Lift public sector productivity by raising efficiency in health care and education. Compensation of some categories of NHS personnel is high by international standards and should be contained. Reinforce competition among health care providers to mitigate price pressures. Improve consistency in the allocation of health care responsibility across government bodies.

Reform planning regulations

Supply of land for housing and commercial development remains low, decreasing affordability and contributing to price volatility and low productivity.

Actions taken: No action taken.

Recommendations: Make the planning system more flexible and predictable and provide incentives for local communities to release land for building, while continuing to protect the environment.

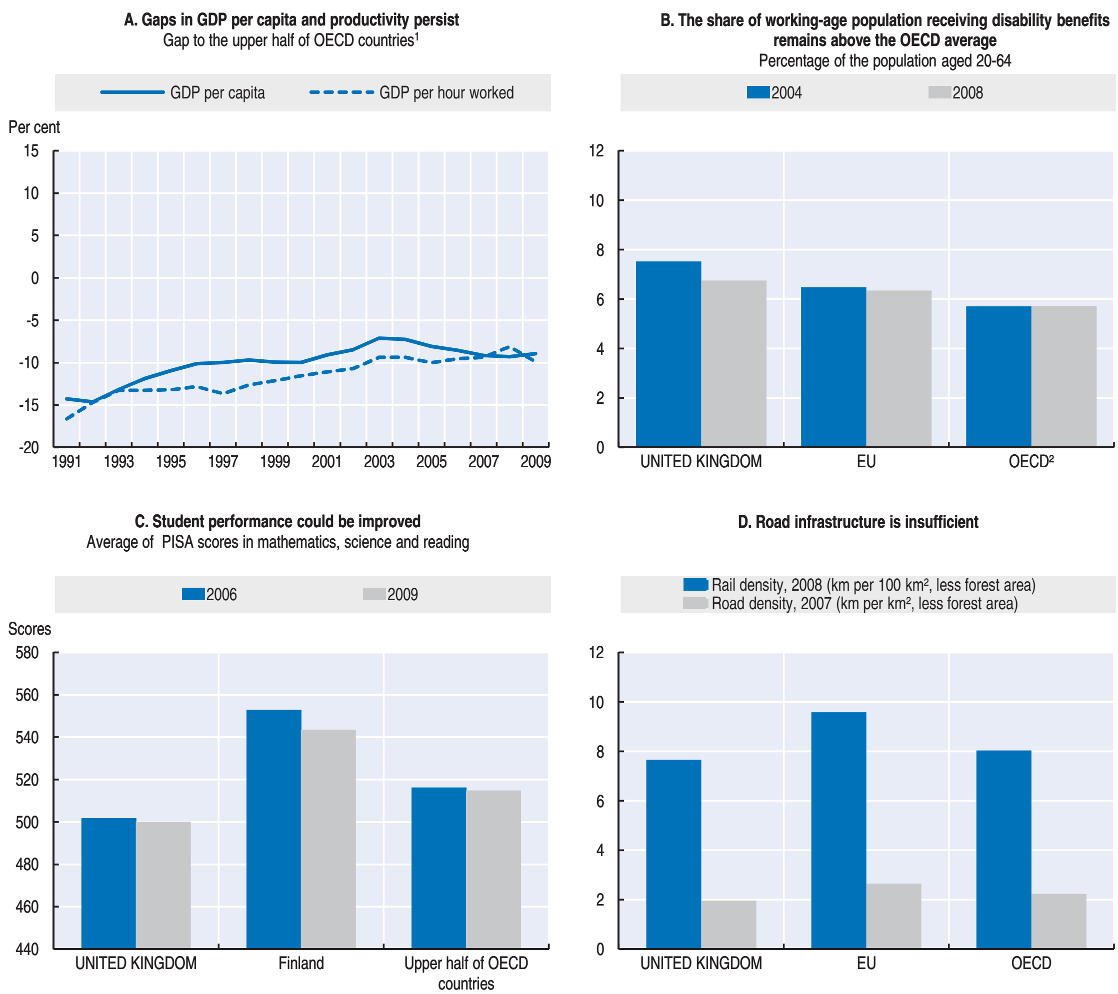
UNITED KINGDOM

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		1.8	2.3	1.3
Labour utilisation		0.1	0.2	0.1
of which:	Employment rate	0.5	0.6	0.4
	Average hours	–0.4	–0.4	–0.3
Labour productivity		1.7	2.2	1.3
of which:	Capital intensity	1.0	1.2	0.8
	Multifactor productivity	0.7	1.0	0.5

Source: Estimates based on OECD (2010), *OECD Economic* Outlook No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. Excluding Chile.

Source: Chart A: OECD, *National Accounts* and *OECD Economic* Outlook No. 88 *Databases*; Chart B: OECD (2010), *Sickness, Disability and Work: Breaking the Barriers: A Synthesis of Findings across OECD Countries*; Chart C: OECD, *PISA 2009 Database*; Chart D. World Bank, *World Development Indicators*.

StatLink http://dx.doi.org/10.1787/888932374350

UNITED STATES

GDP per capita continues to be among the highest in the OECD, mainly reflecting high labour productivity. A surge in labour productivity during the recent recession has increased the performance of US workers relative to the OECD average, but relative labour utilisation has declined. Health care and financial sector reforms have recently been enacted, but more needs to be done in the following areas.

Priorities supported by indicators

Improve primary and secondary education

Despite high levels of expenditures per pupil, international student test (PISA) scores are below the OECD average.

Actions taken: The Race to the Top fund offers competitive grants to encourage states to adopt education standards, improve student assessment, and strengthen teacher evaluations. The Blueprint for Elementary and Secondary Education Act (ESEA) reform includes measures to improve early education.

Recommendations: Improve teacher education and development using evidence on approaches that have proven to be effective in raising student achievement. Strengthen schools' accountability for student progress.

Improve the efficiency of the health care sector

Total health care expenditures are high and rising quickly. There is considerable scope to improve the efficiency of the system.

Actions taken: The 2010 health reform expands coverage and pays for it through health expenditure savings and additional taxes. The reform includes measures to reduce expenditure in the long term but there is much uncertainty about their effects.

Recommendations: Congress should not override the Medicare expenditure restraints in the 2010 reform. Medicare provider payment reforms that prove to be successful in pilot tests should be adopted. The health tax exclusion (*i.e.* the exclusion from taxable income and payroll tax of compensation in the form of health insurance cover) should be limited further than planned to reduce incentives to buy health plans with little cost sharing.

Improve the efficiency of the tax system

Large inefficient tax expenditures and a relatively low reliance on consumption taxes increase the excess burden of taxation.

Actions taken: No action taken.

Recommendations: Broaden the tax base by reducing the value of the mortgage-interest deduction on owner-occupied housing and limiting the health tax exclusion. Shift the weight of taxation from personal income towards consumption-based taxes such as a VAT.

Other key priorities

Reduce agricultural subsidies

Higher prices have reduced agricultural subsidies as a share of gross farm receipts further below the OECD average, but significant subsidies in the form of import restrictions and price support remain.

Actions taken: No action taken.

Recommendations: Reduce support for agricultural producers – notably tariffs on imported ethanol and sugar – and dairy price supports.

Strengthen policies to promote social mobility

Intergenerational mobility in the United States is notably lower than in most other OECD countries with data. Lower mobility may undermine the allocation of human capital across the economy and thereby reduce productivity.

Actions taken: The Administration has set an ambitious goal to increase the share of college graduates. The Blueprint for ESEA Reform, the Race to the Top fund, and the Investing in Innovation fund all provide incentives for states to raise student achievement in low-achievement schools.

Recommendations: Improve equality of opportunity in education by increasing participation in early childhood education, increasing the socio-economic mix of students in schools, giving schools incentives to reduce the impact of socio-economic backgrounds on outcomes, reducing the large disparities in funding per student across schools, and reducing financial barriers to participation in tertiary education. Reduce childhood poverty.

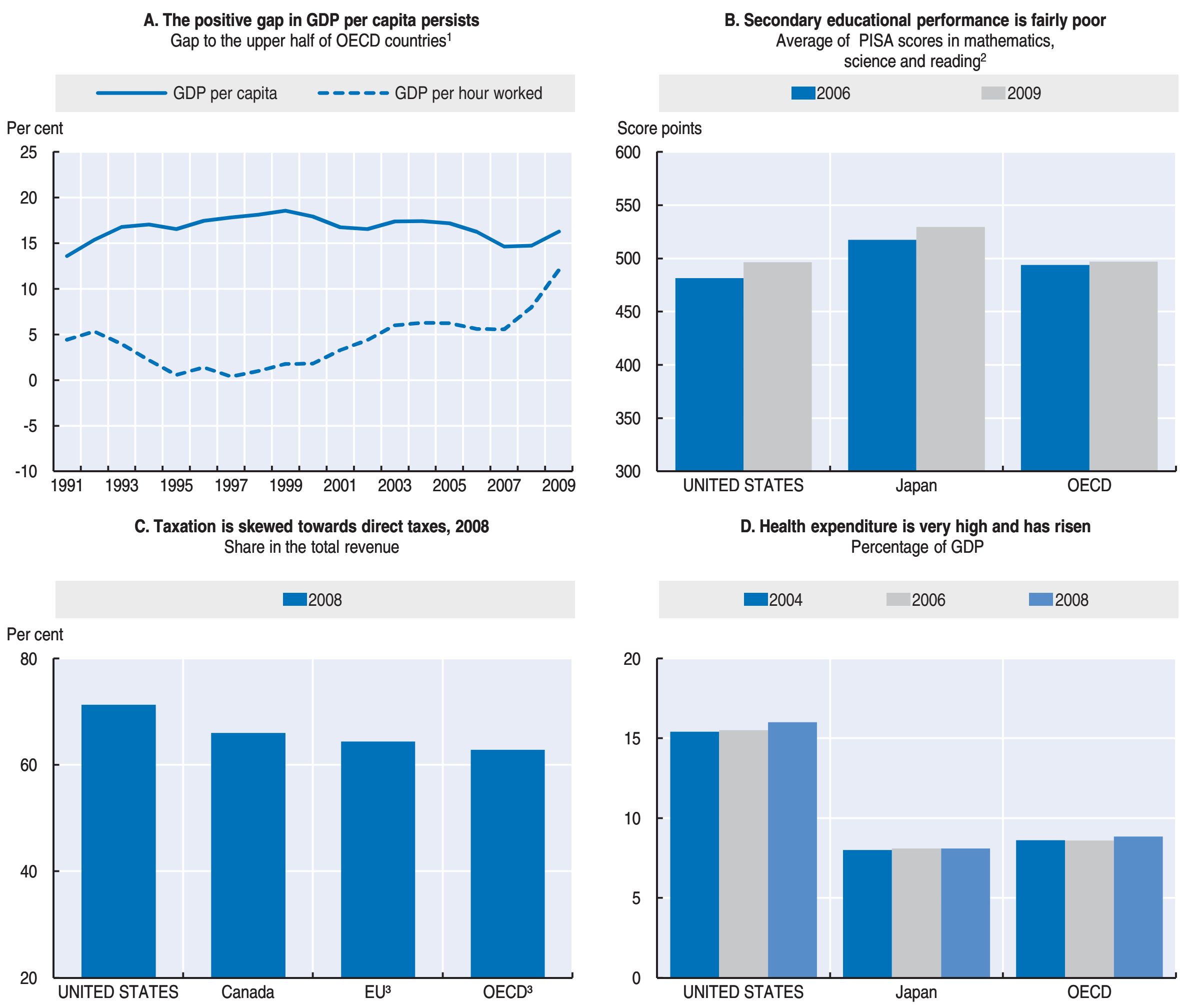
UNITED STATES

Structural indicators

Average annual trend growth rates, per cent

		1999-2009	1999-2004	2004-09
GDP per capita		1.5	1.8	1.2
Labour utilisation		–0.4	–0.3	–0.6
of which:	Employment rate	–0.3	–0.1	–0.4
	Average hours	–0.2	–0.2	–0.2
Labour productivity		1.9	2.1	1.7
of which:	Capital intensity	1.2	1.3	1.1
	Multifactor productivity	0.7	0.8	0.7

Source: Estimates based on OECD (2010), *OECD Economic Outlook* No. 88: *Statistics and Projections Database.*



1. Percentage gap with respect to the simple average of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2005 PPPs).
2. For the United States average in mathematics and science only in 2006.
3. Average of European countries in the OECD. EU and OECD averages exclude Chile, Estonia, Israel and Slovenia.

Source: Chart A: OECD, *National Accounts* and *OECD Economic Outlook* No. 88 *Databases*; Chart B: OECD, *PISA 2009 Database*; Chart C: OECD, *Tax Revenue Database*; Chart D: OECD, *Health Database*.

StatLink http://dx.doi.org/10.1787/888932374369

Economic Policy Reforms 2011
Going for Growth

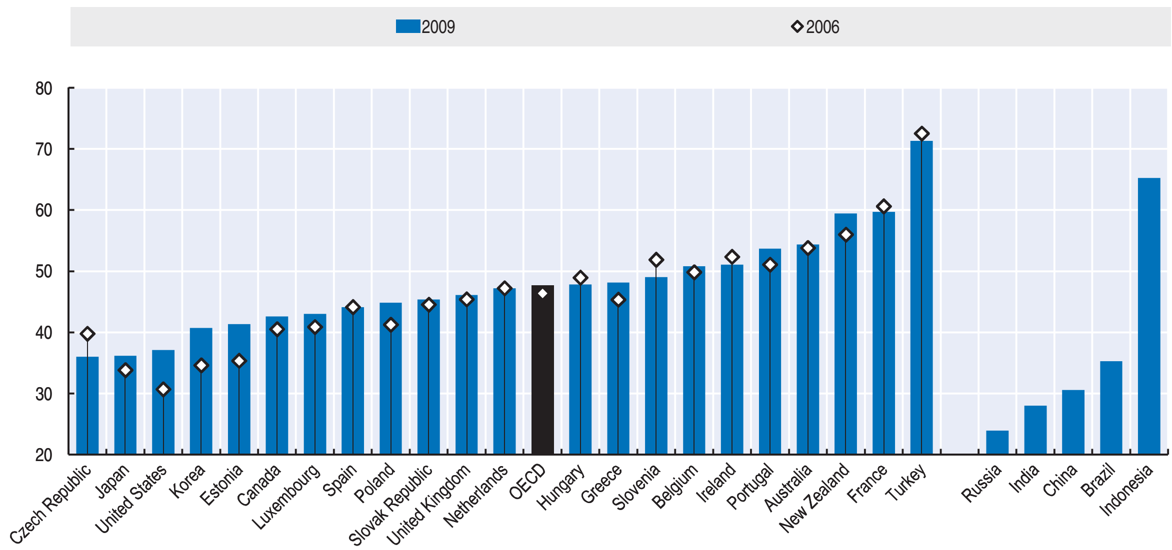
PART I

Chapter 3

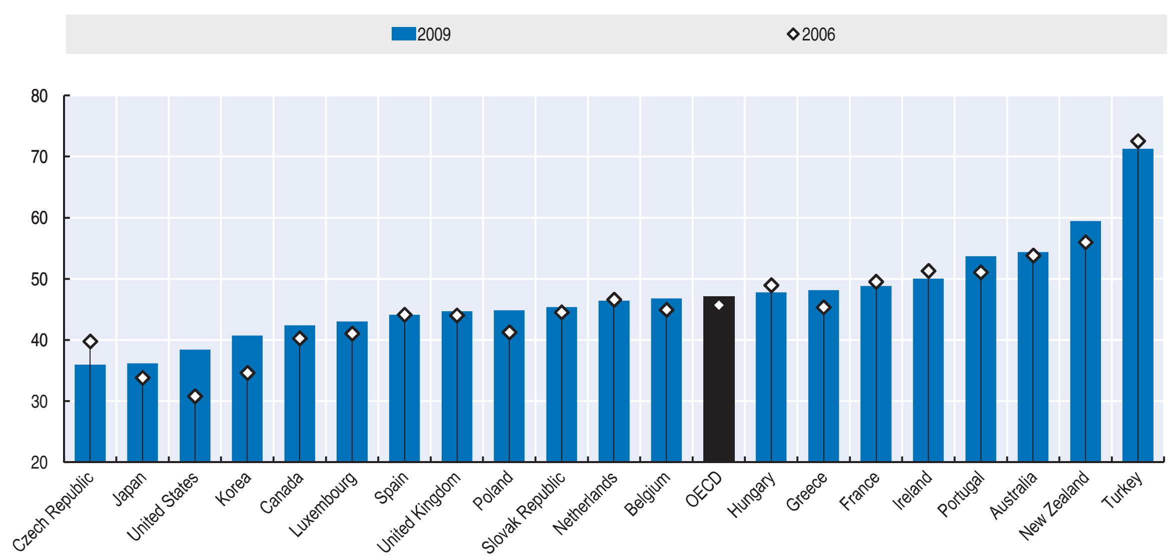
Structural Policy Indicators

Figure 3.1. **Cost of labour**

A. Minimum wages[1]
Percentage of median wage[2]



B. Minimum cost of labour[3]
Percentage of labour cost of median worker[2]



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. Missing countries do not have a national statutory minimum wage except for Mexico, Chile and Israel for which data are not available.
2. Exactly half of all workers have wages either below or above the median wage for the OECD countries. For the non-OECD countries : percentage of minimum to average wage for Brazil (2010) and Russia; of minimum to average manufacturing sector wage for China (2008) and India (2005); and average of two minimum wages (Jakarta and the lowest rate in the country) to the average manufacturing sector wage for Indonesia.
3. The cost of labour is the sum of the wage level and the corresponding social security contribution paid by employers.

Source: Chart A: OECD (2010), *OECD Employment Outlook Database* and national statistics for the non-OECD countries; Chart B: OECD (2010), *OECD Employment Outlook* and *Taxing Wages Databases*.

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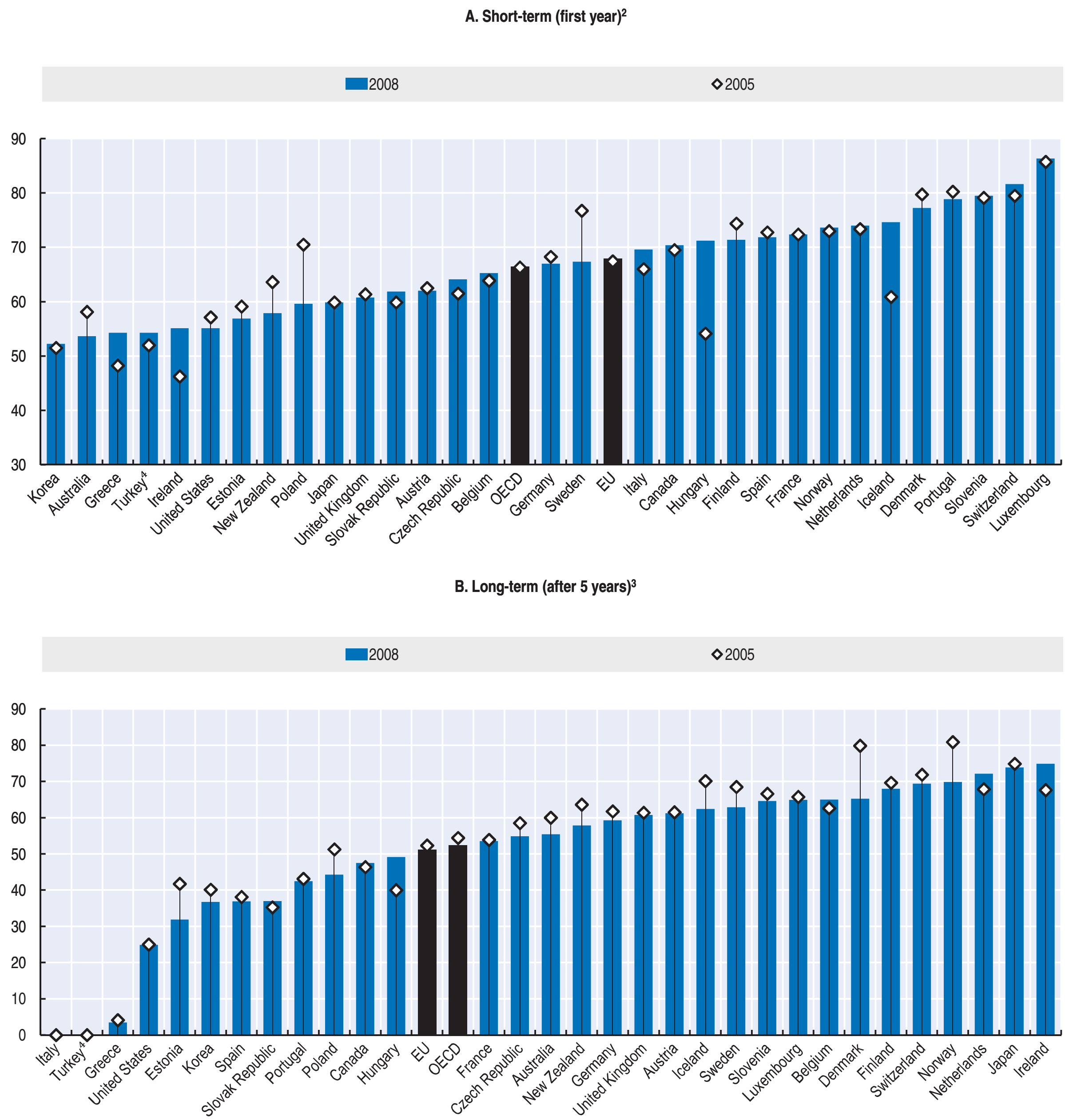
Figure 3.2. **Net income replacement rates for unemployment**[1]

Percentage of earnings



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. Average of replacement rates for unemployed persons who earned 67% and 100% of average worker earnings.
2. Initial phase of unemployment but following any waiting period. No social assistance "top-ups" are assumed to be available in either the in-work or out-of-work situation. Any income taxes payable on unemployment benefits are determined in relation to annualised benefit values (*i.e.* monthly values multiplied by 12) even if the maximum benefit duration is shorter than 12 months.
3. After tax and including unemployment benefits, social assistance, family and housing benefits in the 60th month of benefit receipt. Data for Italy and Turkey are equal to zero in 2005 and 2008.
4. For Turkey, the average worker earnings (AW) value is not available; calculations are based on the average production worker earnings (APW). Years 2006 and 2008.

Source: OECD (2010), *Benefits and Wages Database*.

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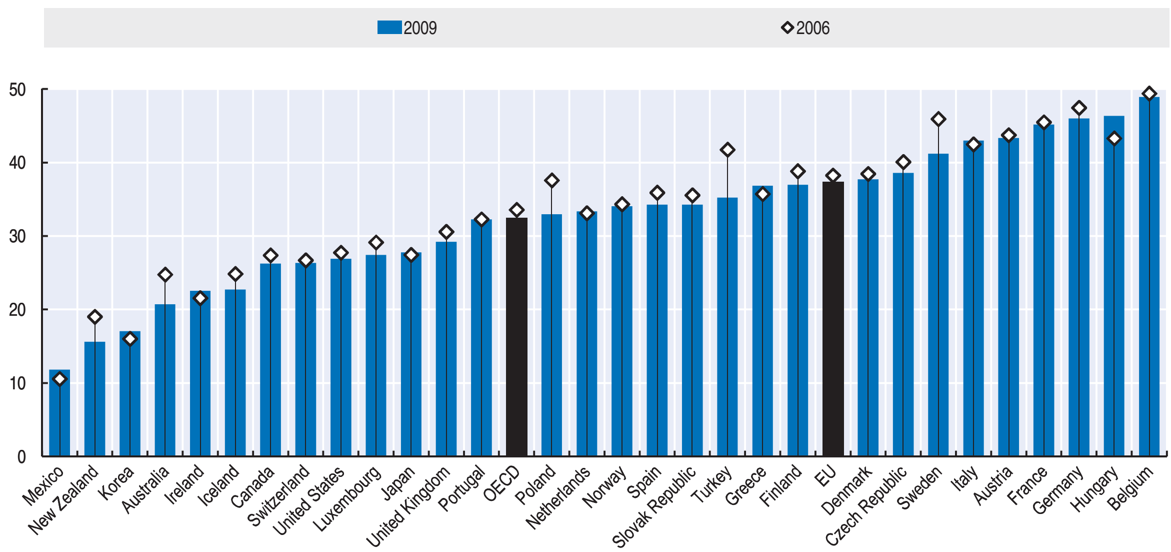
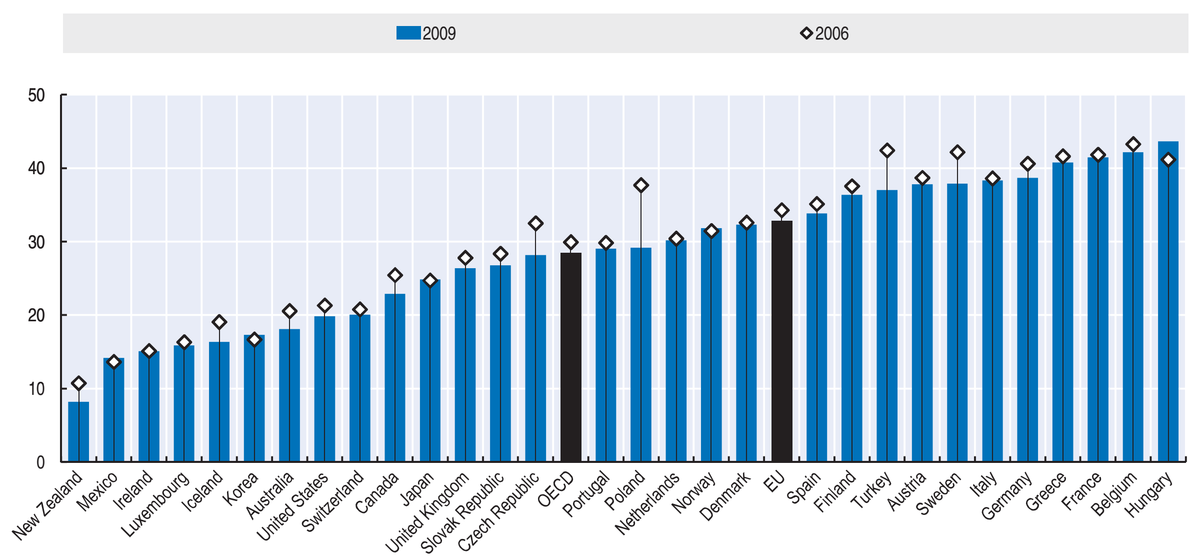
Figure 3.3. **Average tax wedge on labour**[1]

Percentage of total labour compensation

A. At 67% of average worker earnings, single person without children



B. At 100% of average worker earnings, couple with two children[2]



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. Measured as the difference between total labour compensation paid by the employer and the net take-home pay of employees, as a ratio of total labour compensation. It therefore includes both employer and employee social security contributions.
2. Average of three situations regarding the wage of the second earner.

Source: OECD (2010), *Taxing Wages Database*.

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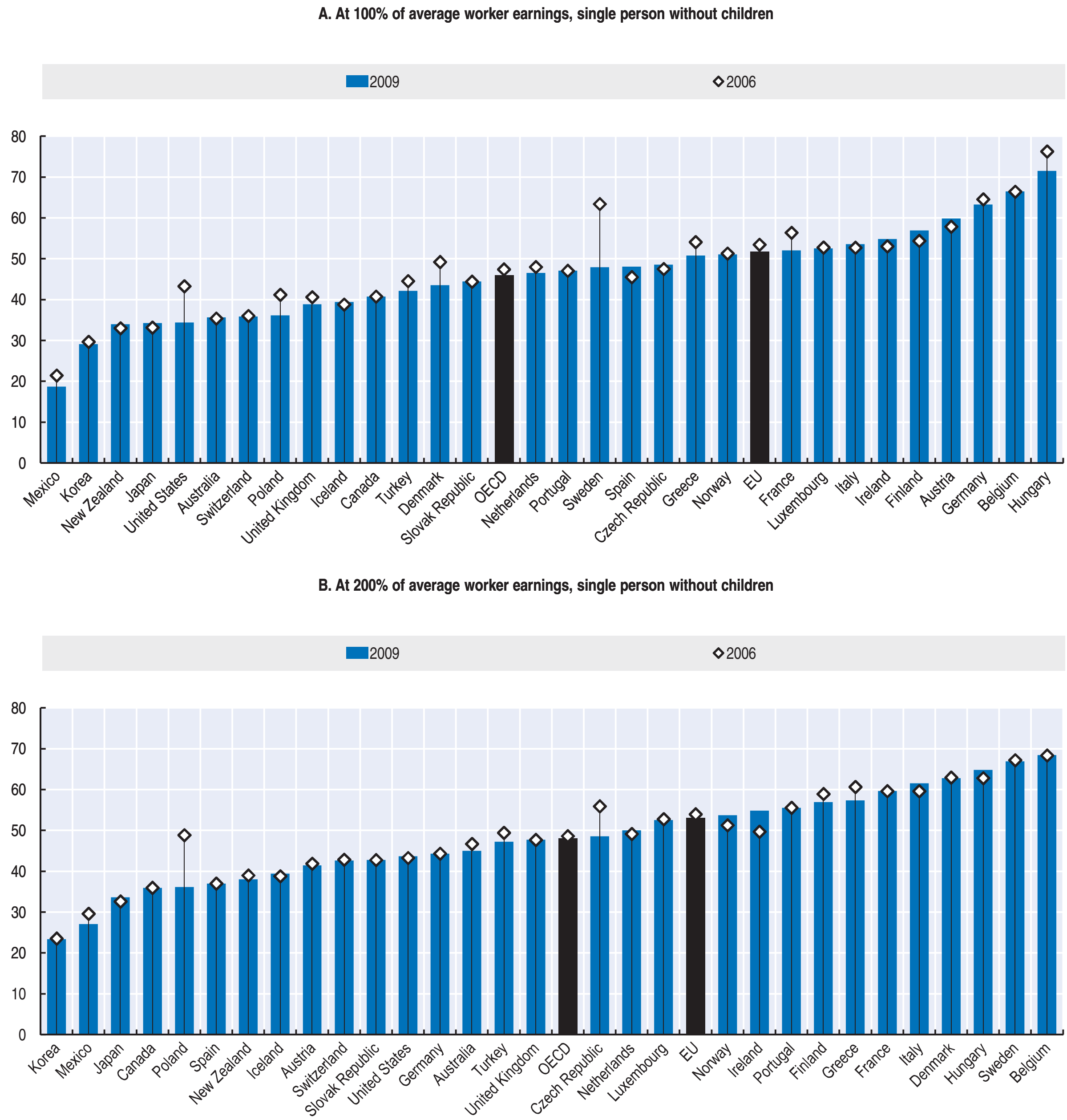
Figure 3.4. **Marginal tax wedge on labour**[1]

Percentage of total labour compensation



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. Measured as the difference between the change in total labour compensation paid by employers and the change in the net take-home pay of employees, as a result of an extra unit of national currency of labour income. The difference is expressed as a percentage of the change in total labour compensation.

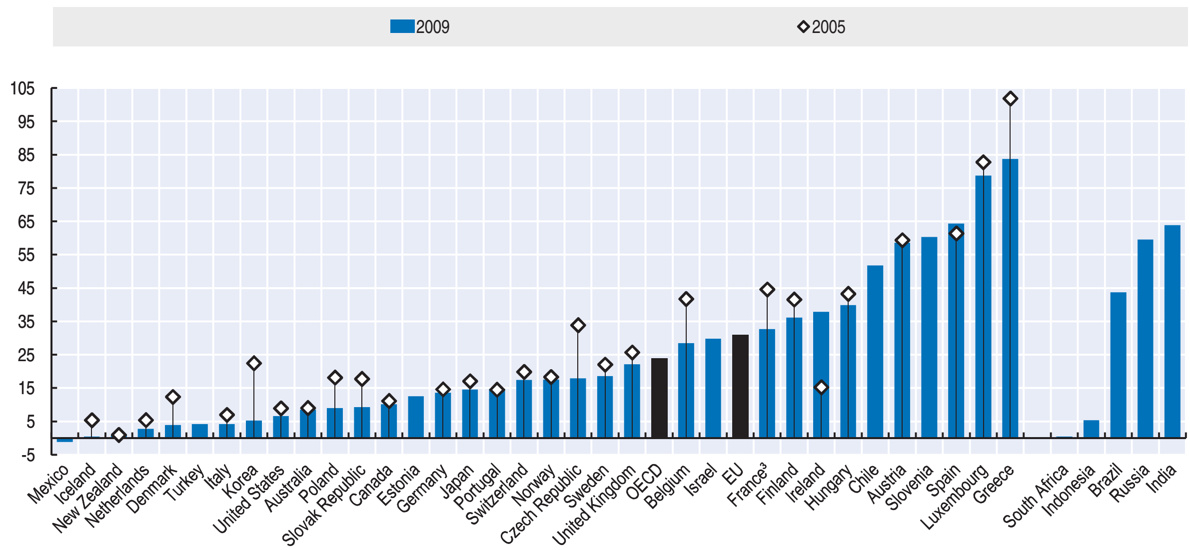
Source: OECD (2010), *Taxing Wages Database*.

StatLink http://dx.doi.org/10.1787/888932373153

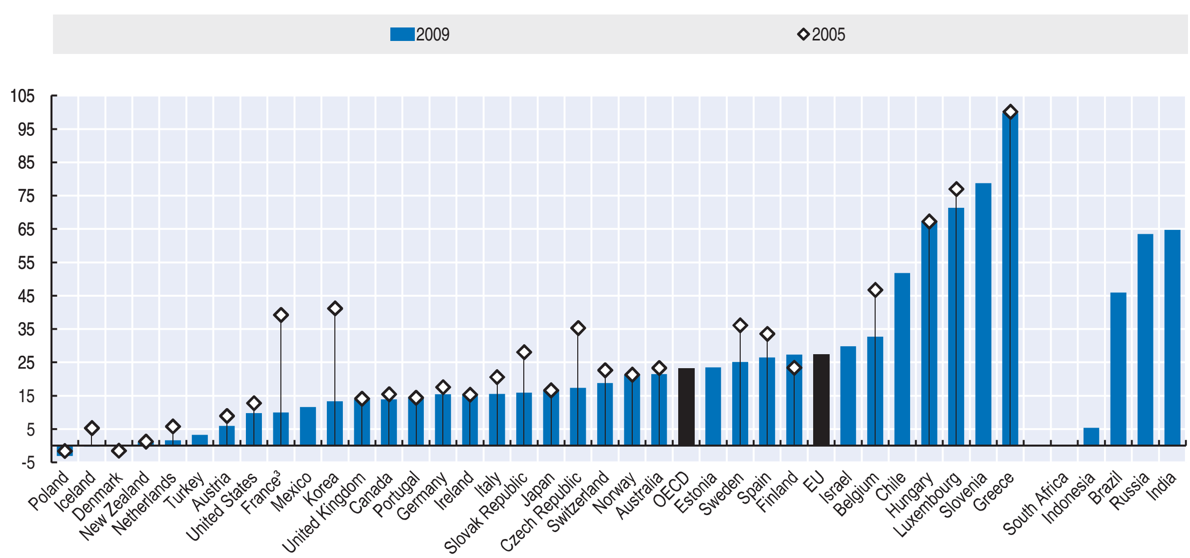
Figure 3.5. **Implicit taxes on continued work at older ages**

Percentage of average worker earnings

A. Implicit tax on continued work: early retirement[1]



B. Implicit tax on continued work: old-age pensions[2]



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. Average of implicit tax on continued work in early retirement route, average for 55 and 60-year-olds workers.
2. Implicit tax on continued work in regular old-age pension systems, for 60-year-olds. Data for South-Africa is equal to zero in 2009.
3. For France, year 2010.

Source: Duval, R. (2003), "The Retirement Effects of Old-Age Pension and Early Retirement Schemes in OECD Countries", *OECD Economics Department Working Papers,* No. 370 and OECD calculations.

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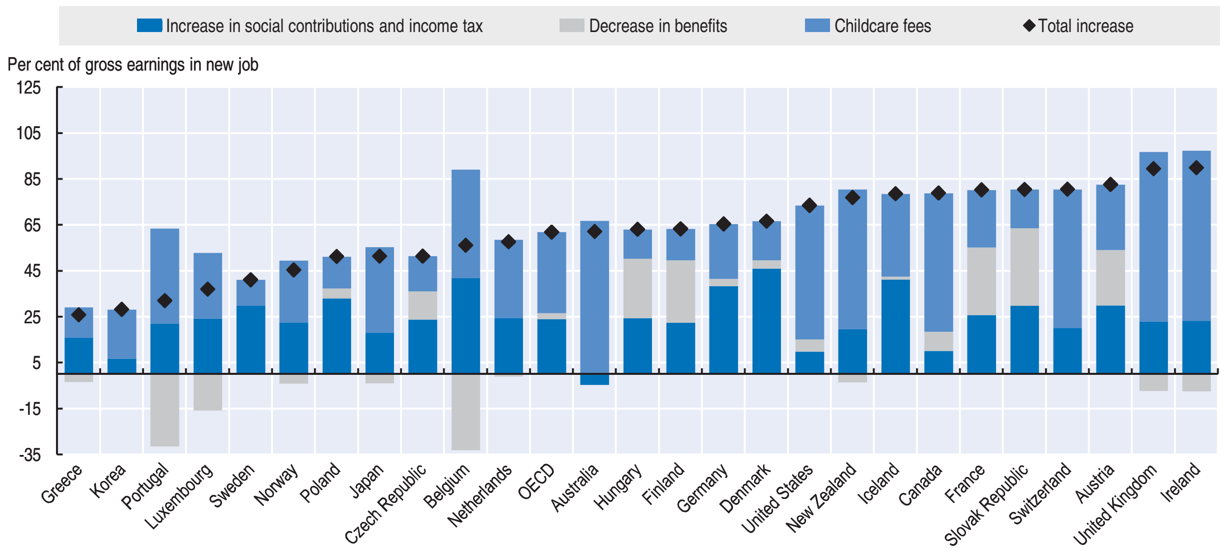
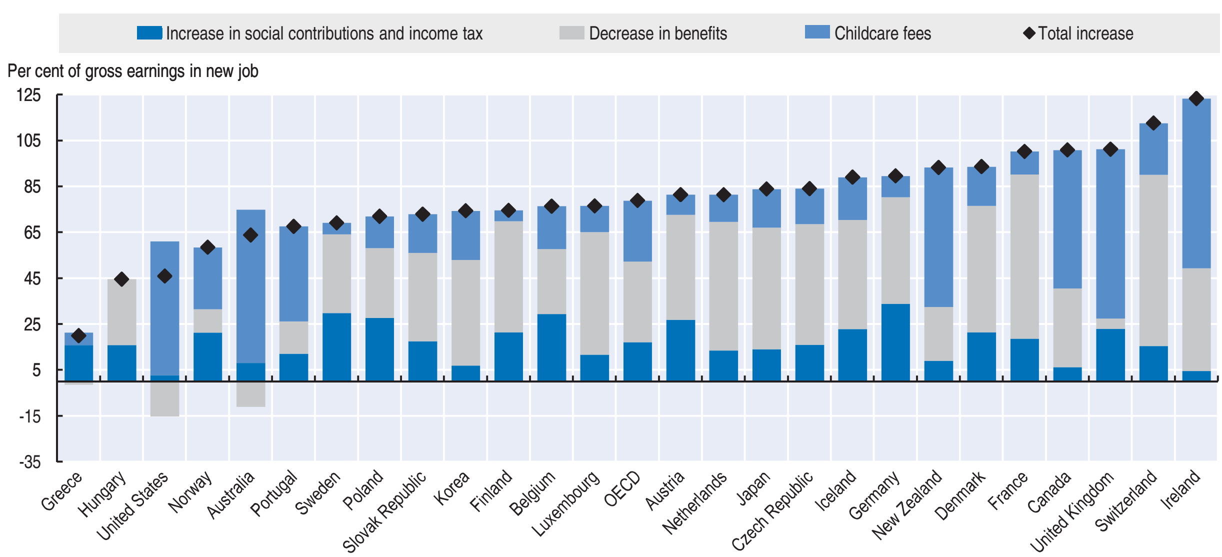
Figure 3.6. **Implicit tax on returning to work**[1]

A. Second earner



B. Lone parent



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

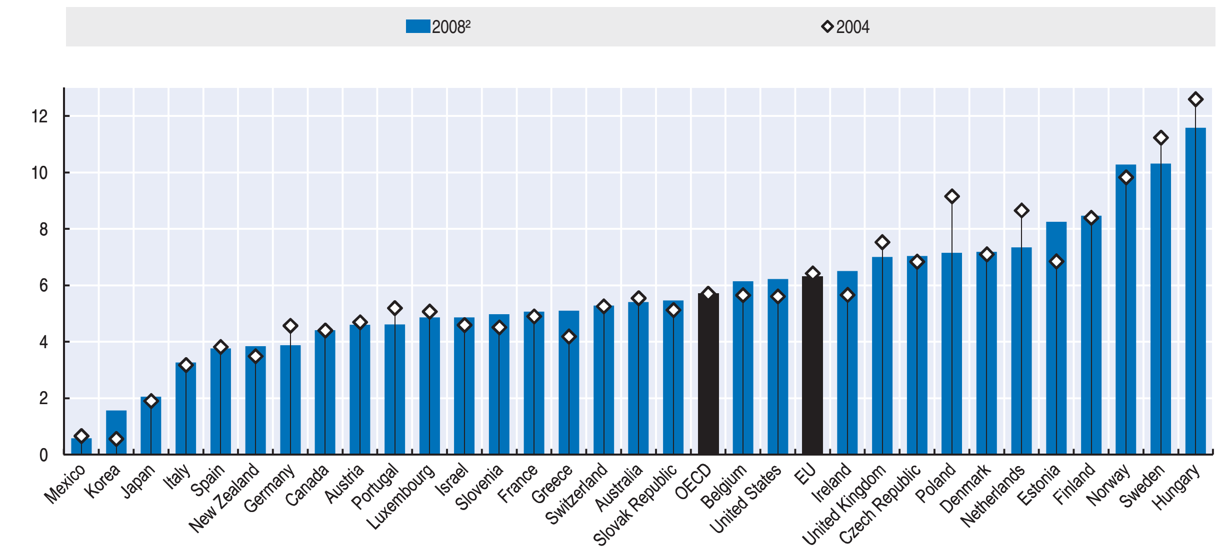
1. Taking into account childcare fees and changes of taxes and benefits in case of a transition to a job paying two-thirds of average worker earnings in 2004.

Source: OECD (2004), *Benefits and Wages*: OECD Indicators.

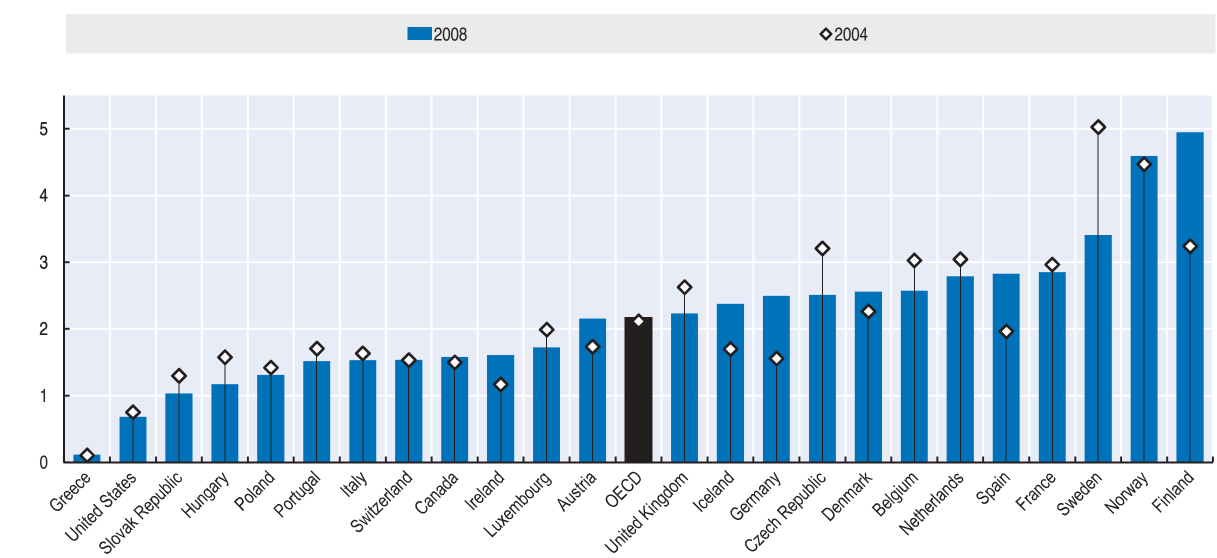
StatLink http://dx.doi.org/10.1787/888932373191

Figure 3.7. **Income support for disability and sickness**

A. Per cent of population aged 20-65 years old receiving disability benefits[1]



B. Number of weeks lost due to sickness leave



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

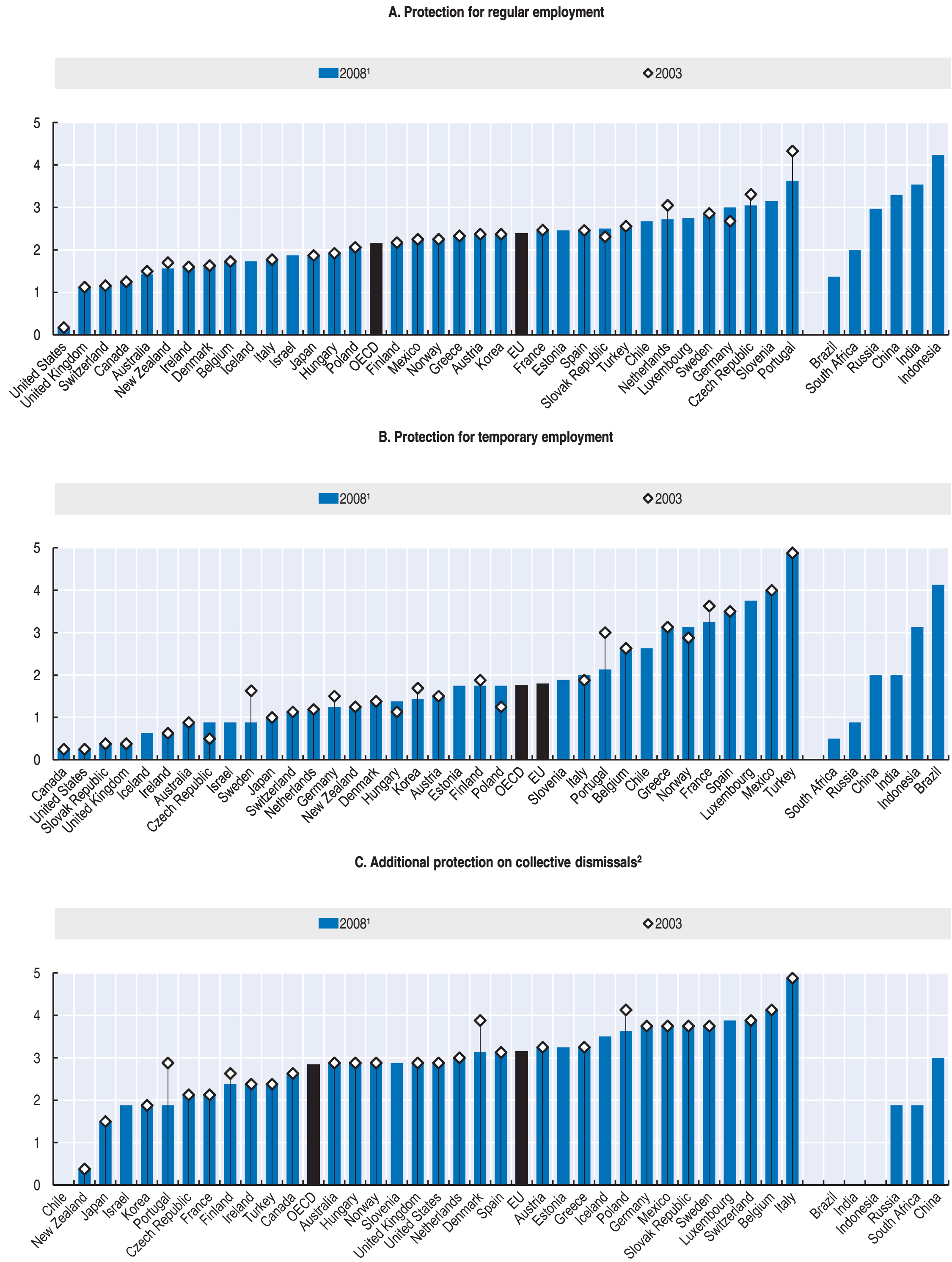
1. Disability benefits include benefits received from schemes to which beneficiaries have paid contributions (contributory), programmes financed by general taxation (non-contributory) and work injury schemes.
2. 2005 for Luxembourg; 2007 for Austria, Canada, France, Israel, Italy, Poland, the Slovak Republic, Spain and the United Kingdom.

Source: OECD (2010), Sickness, Disability and Work: Breaking the Barriers: A Synthesis of Findings across OECD Countries.

StatLink http://dx.doi.org/10.1787/888932373210

Figure 3.8. **Employment Protection Legislation (EPL)**

Index scale of 0-6 from least to most restrictive



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

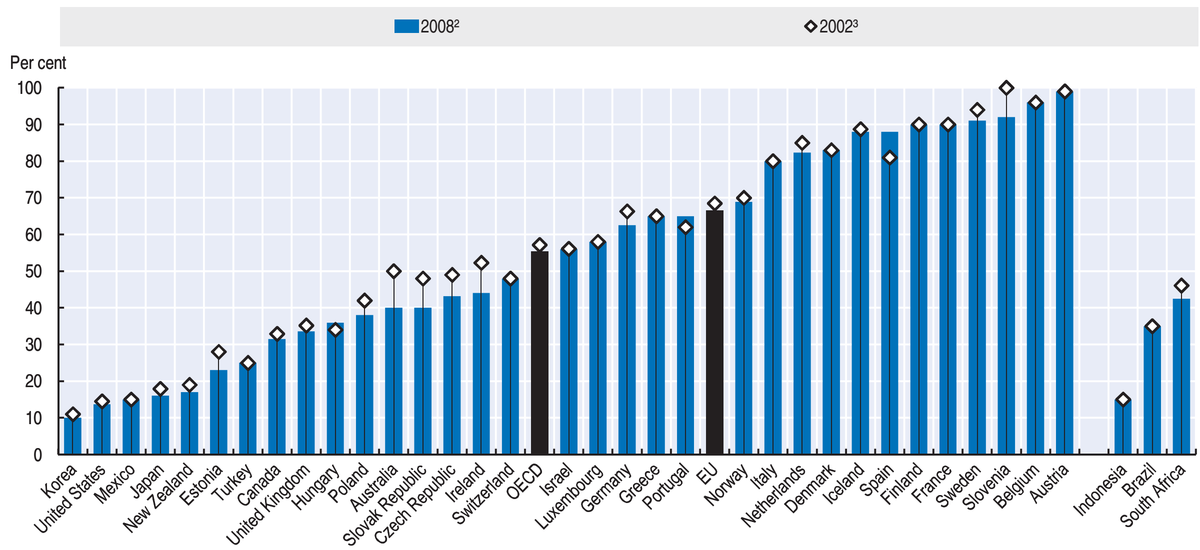
1. 2009 for France and Portugal.
2. Data for Brazil, India and Indonesia are equal to zero in 2008.

Source: OECD (2010), *Employment Database*.

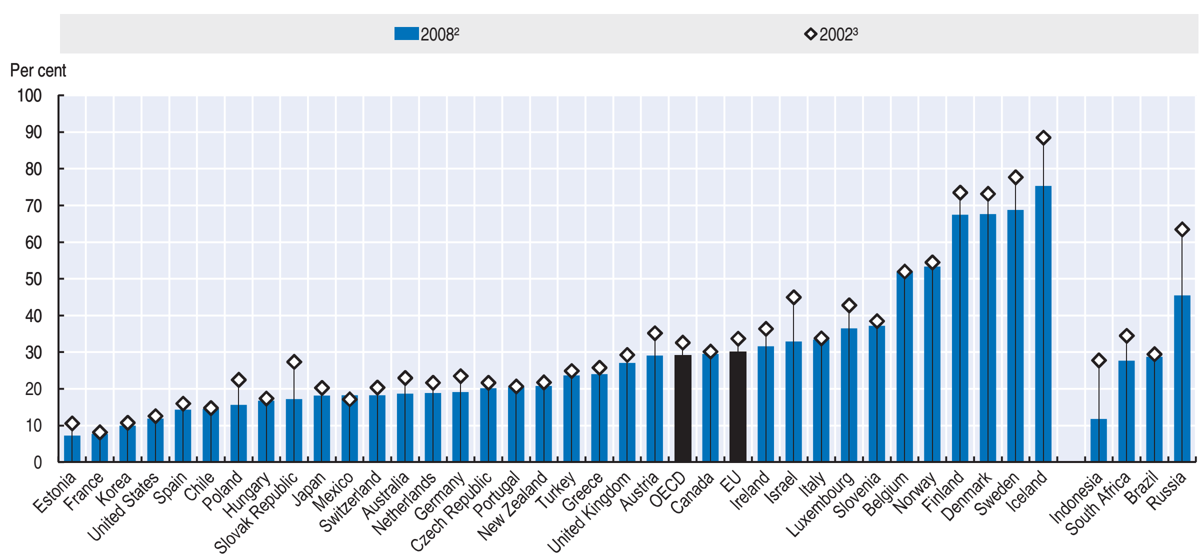
StatLink http://dx.doi.org/10.1787/888932373229

Figure 3.9. **Coverage rates of collective bargaining agreements and trade union density rates**[1]

A. Coverage rate of collective bargaining agreements



B. Trade union density rate



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. The coverage rate is measured as the percentage of workers who are covered by collective bargaining agreements, regardless of whether or not they belong to a trade union. The union density rate is the percentage of workers belonging to a trade union. The rates refer to wage and salary workers.
2. 2007 for Estonia, Israel and Indonesia.
3. 2003 for Brazil, Estonia, Indonesia, Luxembourg and South Africa; 2001 for Greece, Hungary, Poland and Russia; 2000 for Israel.

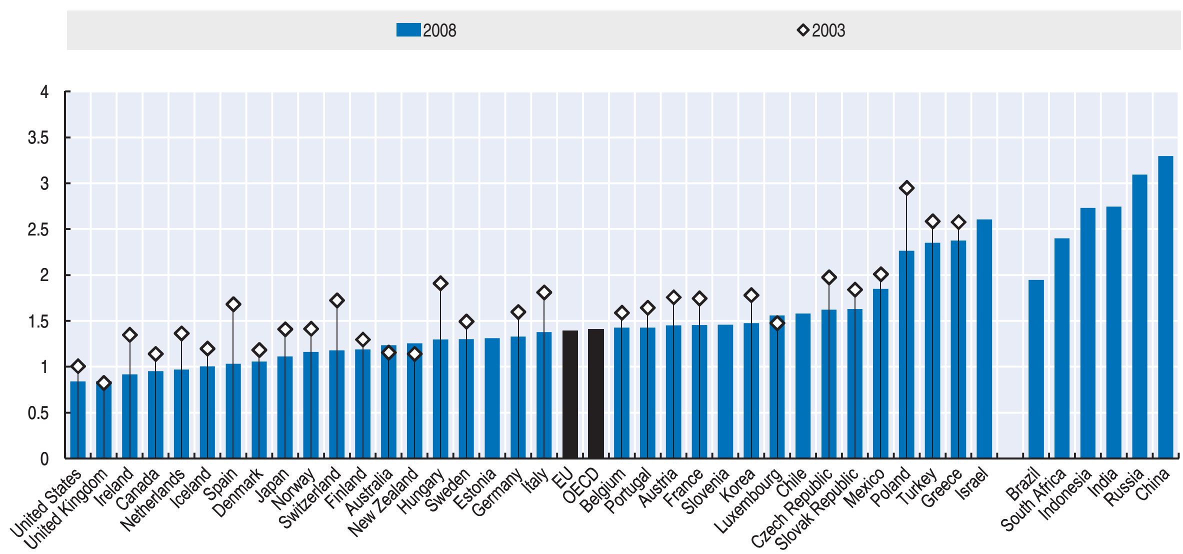
Source: OECD (2010), *OECD Employment Outlook* and J. Visser, Amsterdam Institute for Advanced Labour Studies (2010), *ICTWSS Database* 3.1.

StatLink http://dx.doi.org/10.1787/888932373248

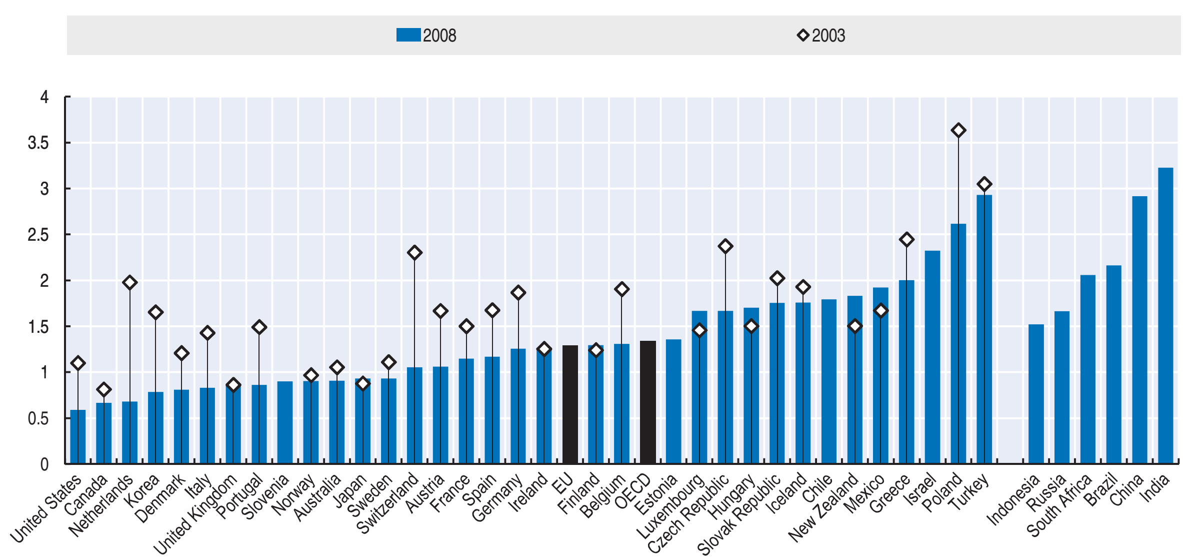
Figure 3.10. **Product market regulation**

Index scale of 0-6 from least to most restrictive

A. Restrictiveness of economy-wide product market regulation



B. Restrictiveness of overall administrative regulation[1]



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. This is a simple average of the two indicators for regulatory and administrative opacity and administrative burdens on start-ups.

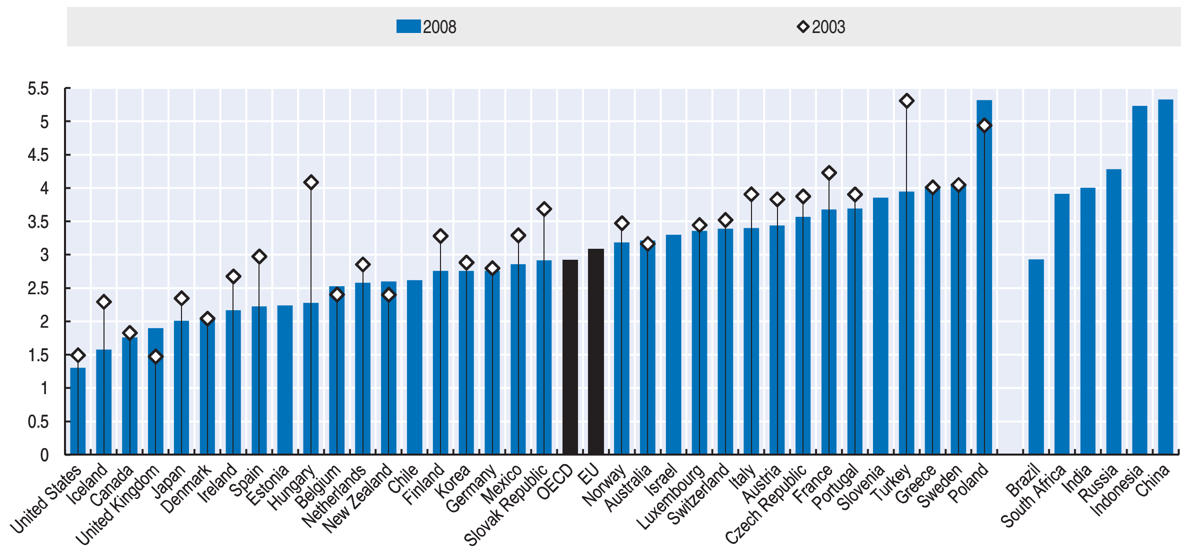
Source: OECD (2010), *Product Market Regulation Database* and Woefl, A. *et al.* (2010), "Product Market Regulation: Extending the Analysis Beyond OECD Countries", *OECD Economics Department Working Papers*, No. 799.

StatLink http://dx.doi.org/10.1787/888932373267

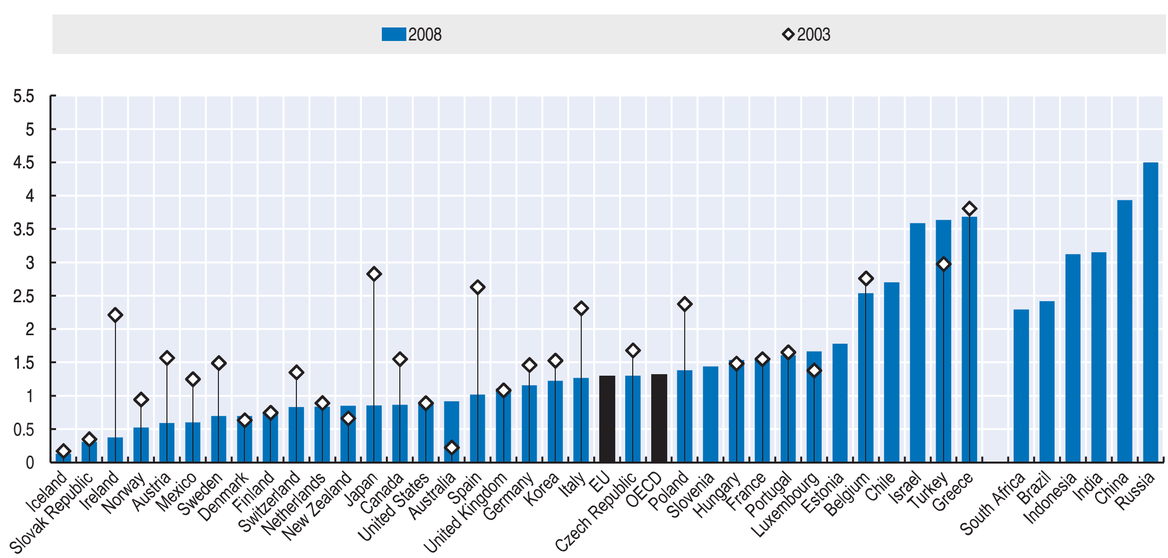
Figure 3.11. **State control of business operations**

Index scale of 0-6 from least to most restrictive

A. Extent of public ownership[1]



B. State involvement in business operations[2]



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. Covers scope and size of public enterprise as well as the direct state control over business enterprise (via voting rights or legislative bodies).
2. Concerns the involvement of the state in business operations via price controls or the use of command and control regulation.

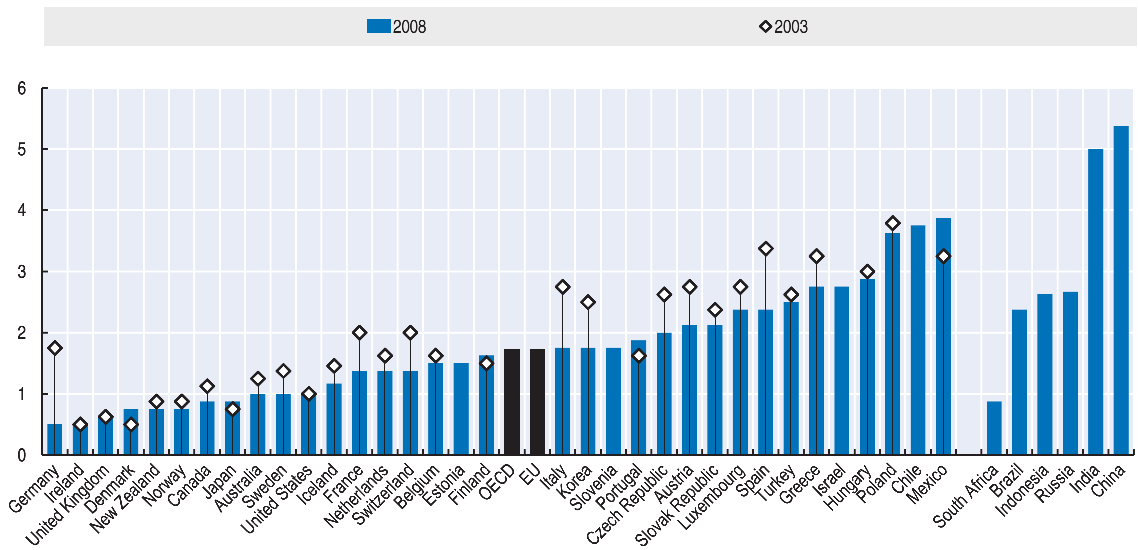
Source: OECD (2010), *Product Market Regulation Database* and Woefl, A. *et al.* (2010), "Product Market Regulation: Extending the Analysis Beyond OECD Countries", *OECD Economics Department Working Papers*, No. 799.

StatLink http://dx.doi.org/10.1787/888932373286

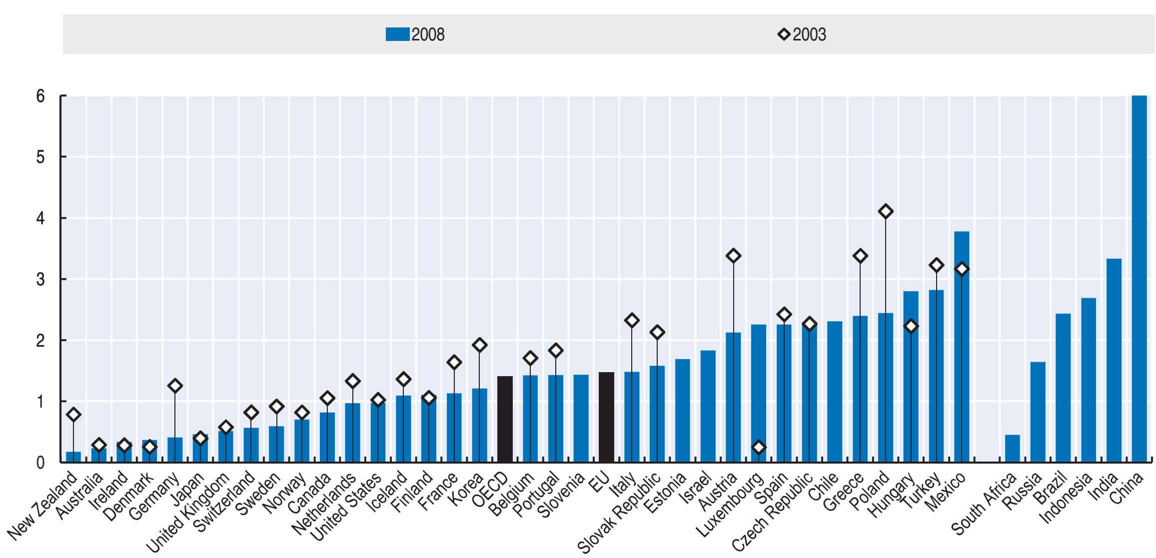
Figure 3.12. **Administrative burdens on entrepreneurship**

Index scale of 0-6 from least to most restrictive

A. Administrative burdens on corporations and sole proprietor start-ups[1]



B. Sector-specific administrative burdens



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

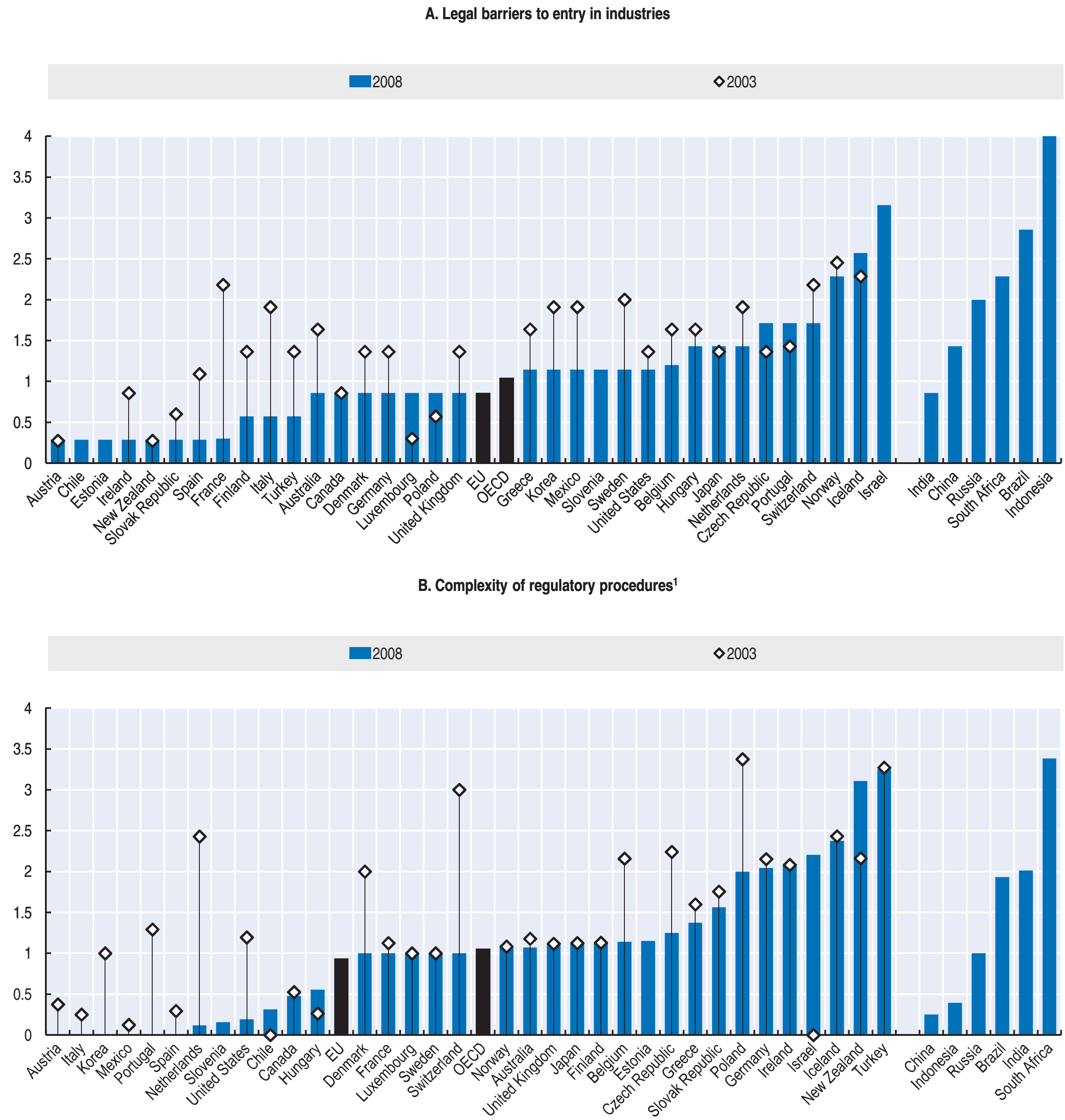
1. This is a simple average of the two indicators of administrative burdens on corporations and sole proprietor start-ups.

Source: OECD (2010), *Product Market Regulation Database* and Woefl, A. *et al.* (2010), “Product Market Regulation: Extending the Analysis Beyond OECD Countries”, *OECD Economics Department Working Papers*, No. 799.

StatLink http://dx.doi.org/10.1787/888932373305

Figure 3.13. **Barriers to entry**

Index scale of 0-6 from least to most restrictive



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

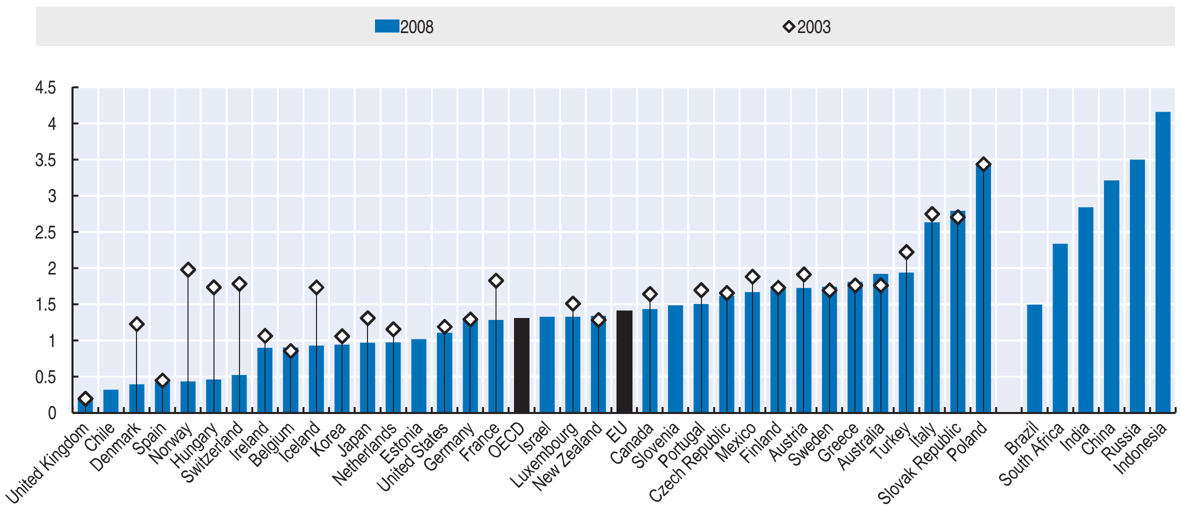
1. Concerns complexity of government communication of rules and procedures as well as of licences and permit systems. Data for Austria, Italy, Korea, Mexico, Portugal and Spain are equal to zero in 2008.

Source: OECD (2010), *Product Market Regulation Database* and Woefl, A. *et al.* (2010), "Product Market Regulation: Extending the Analysis Beyond OECD Countries", *OECD Economics Department Working Papers*, No. 799.

StatLink http://dx.doi.org/10.1787/888932373324

Figure 3.14. **Barriers to foreign direct investment**[1, 2]

Index scale of 0-6 from least to most restrictive



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

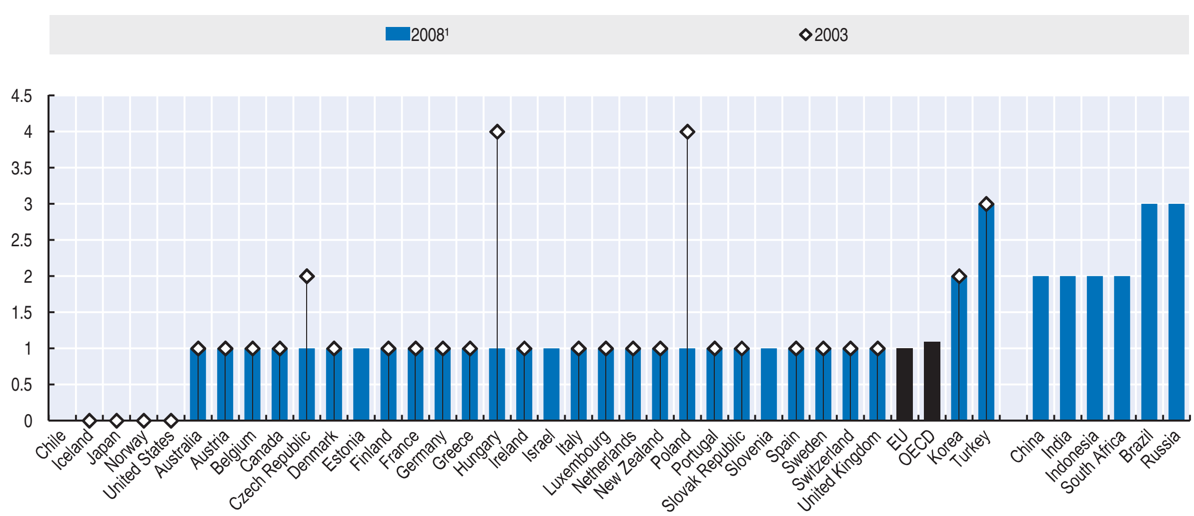
1. This combines restrictions on acquisition of equity by foreign investors in publicly-controlled firms with the general FDI restrictiveness index by Koyama and Golub (2006), "OECD's FDI regulatory restrictiveness index: revision and extension to more economies", *OECD Economics Department Working Papers*, No. 525.
2. The FDI regulation index looks only at statutory restrictions and does not assess the manner in which thay are implemented.

Source: OECD (2010), *Product Market Regulation Database* and Woefl, A. *et al.* (2010), "Product Market Regulation: Extending the Analysis Beyond OECD Countries", *OECD Economics Department Working Papers*, No. 799.

StatLink http://dx.doi.org/10.1787/888932373343

Figure 3.15. **Restrictiveness of external trade tariffs**[1]

Index scale of 0-6 from least to most restrictive



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

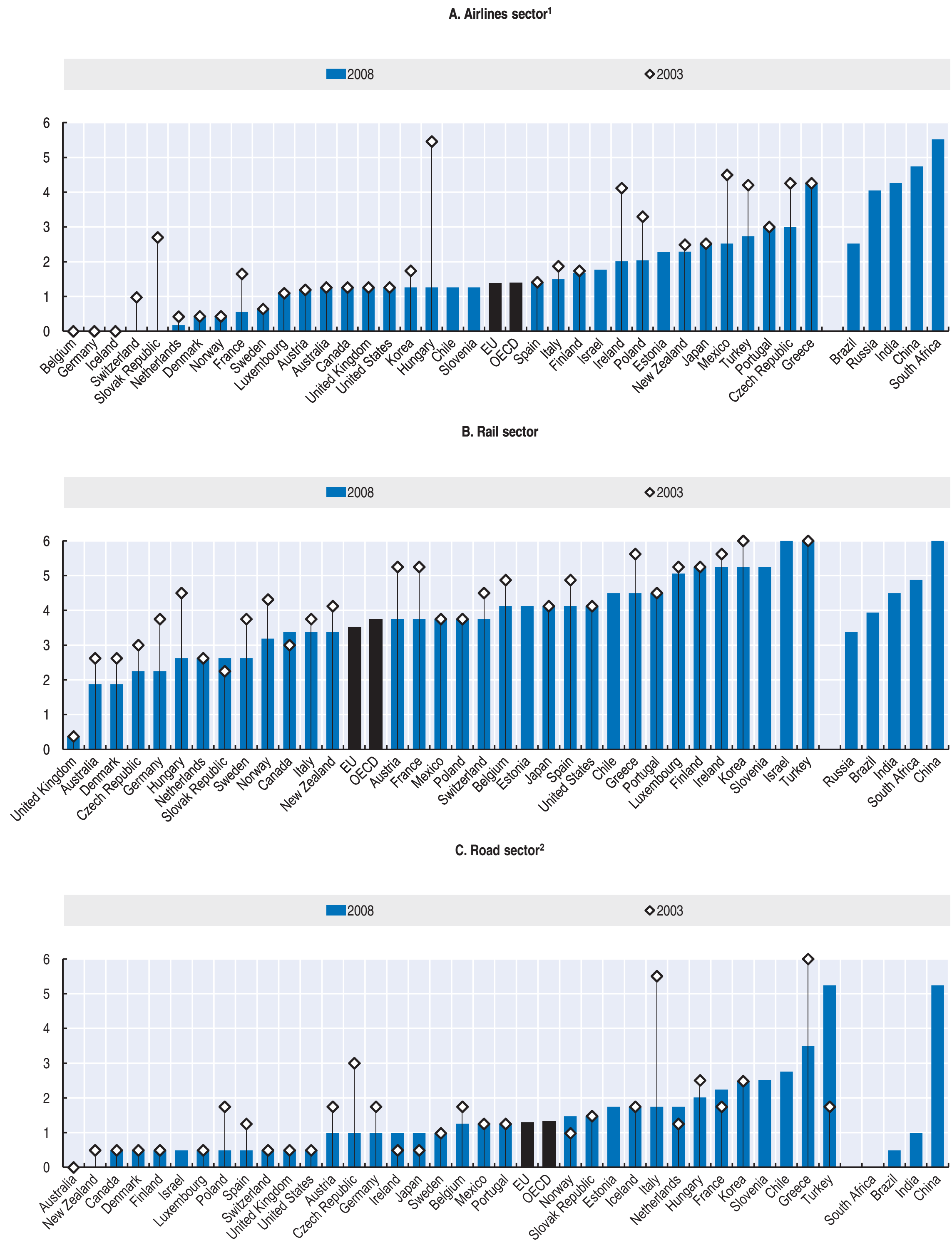
1. Data for Chile, Iceland, Japan, Norway and the United States are equal to zero in 2008.

Source: OECD (2010), *Product Market Regulation Database* and Woefl, A. *et al.* (2010), "Product Market Regulation: Extending the Analysis Beyond OECD Countries", *OECD Economics Department Working Papers*, No. 799.

StatLink http://dx.doi.org/10.1787/888932373362

Figure 3.16. **Sectoral regulation in the transport sector**

Index scale of 0-6 from least to most restrictive



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. Data for Belgium, Germany, Iceland, Switzerland and the Slovak Republic are equal to zero in 2008.
2. Data for Australia, New Zealand and South Africa are equal to zero in 2008.

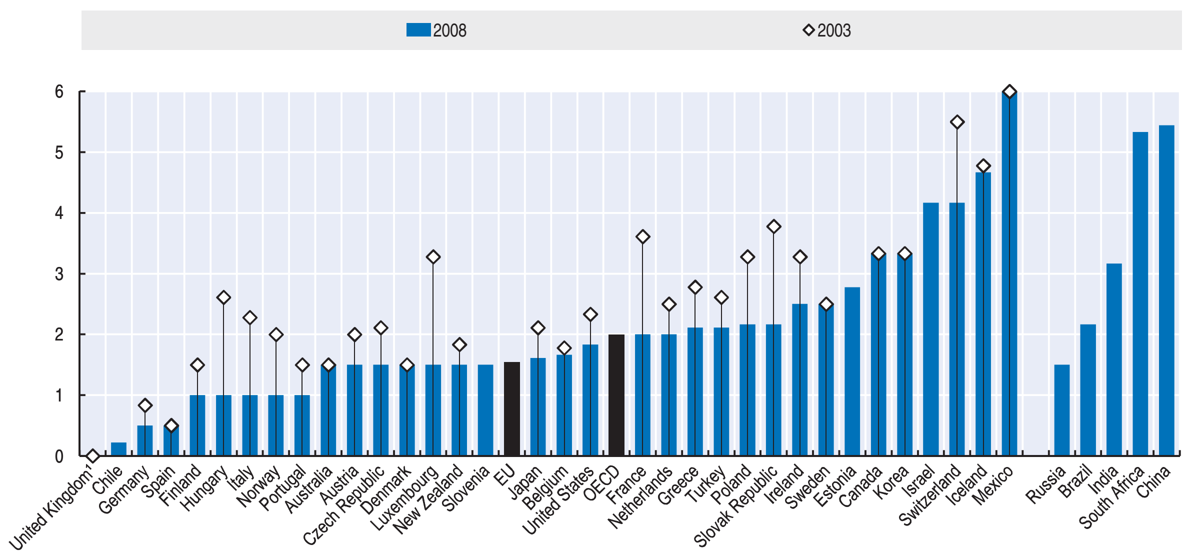
Source: OECD (2010), *Product Market Regulation Database*.

StatLink http://dx.doi.org/10.1787/888932373381

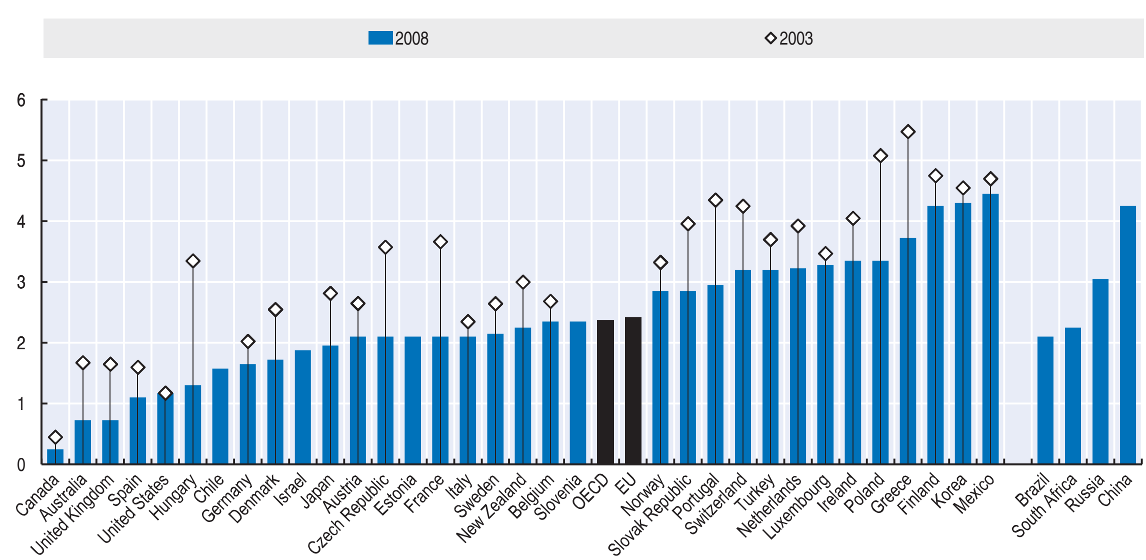
Figure 3.17. **Sectoral regulation in the energy sector**

Index scale of 0-6 from least to most restrictive

A. Electricity sector



B. Gas sector



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

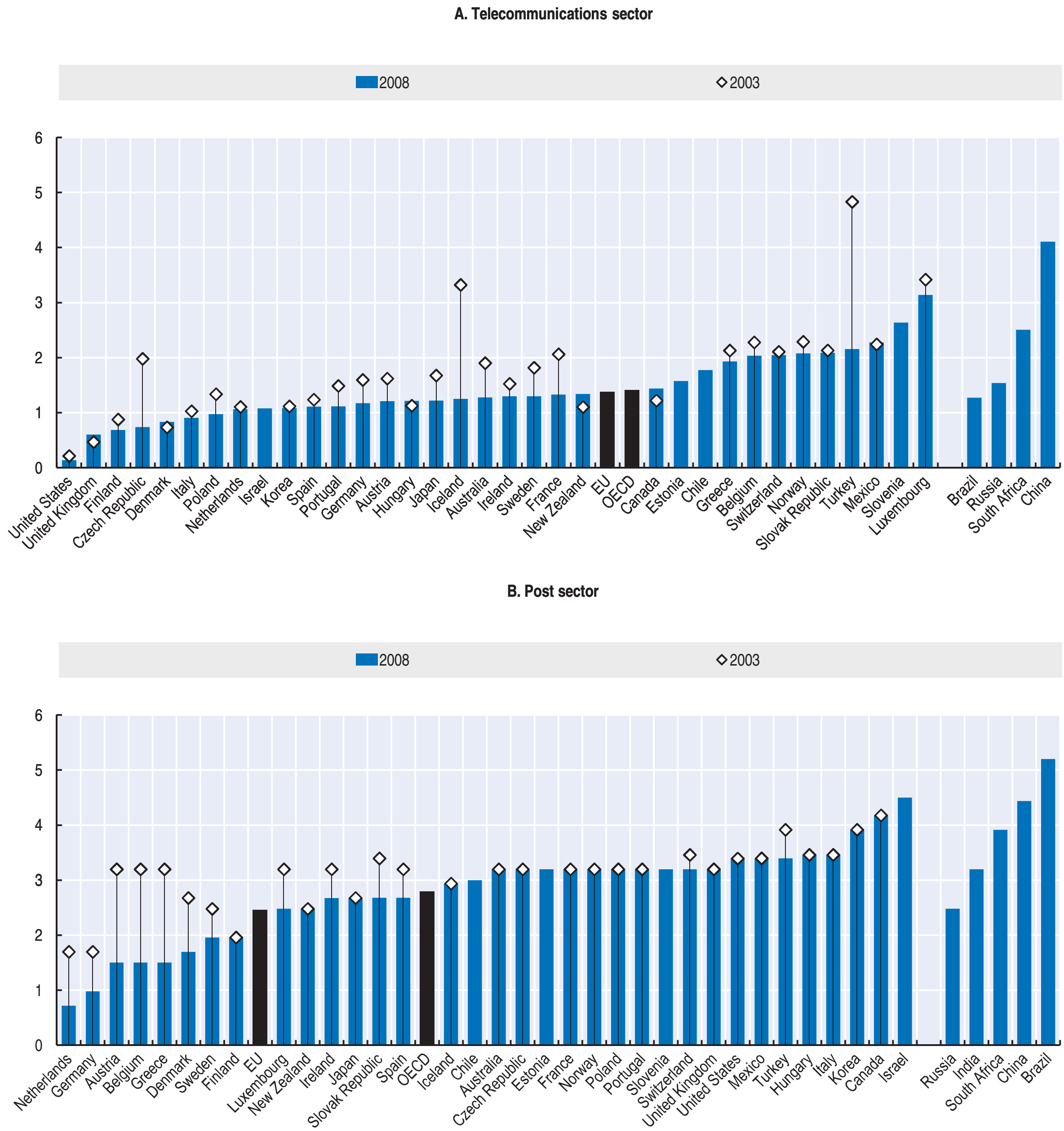
1. Data for the United Kingdom is equal to zero in 2008.

Source: OECD (2010), *Product Market Regulation Database*.

StatLink http://dx.doi.org/10.1787/888932373400

Figure 3.18. **Sectoral regulation in the post and telecommunications sector**

Index scale of 0-6 from least to most restrictive



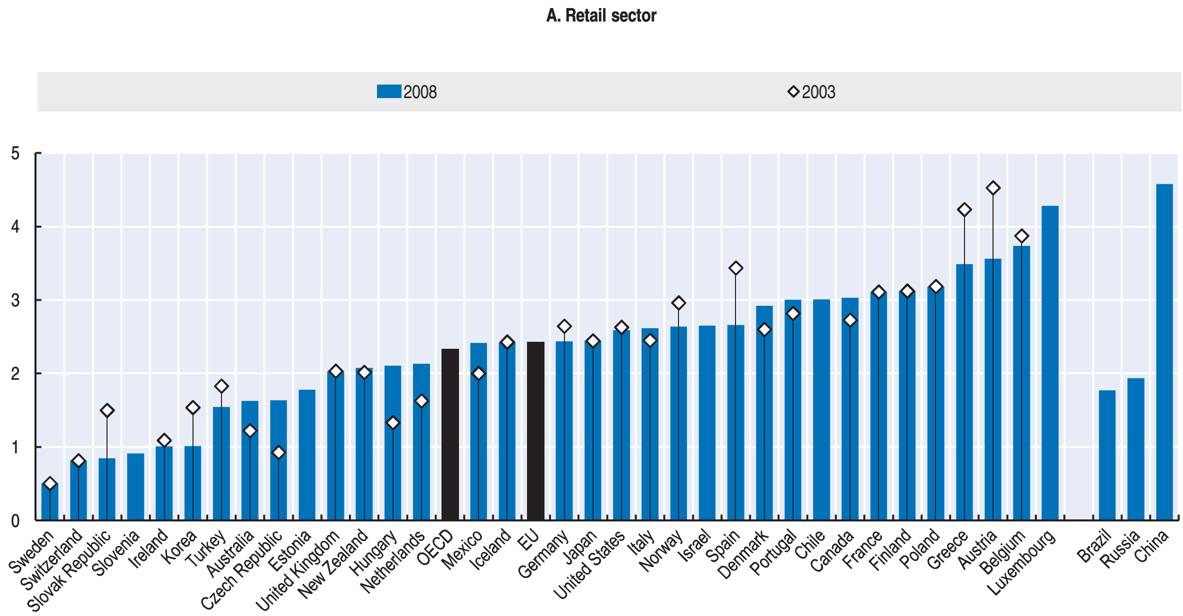
Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

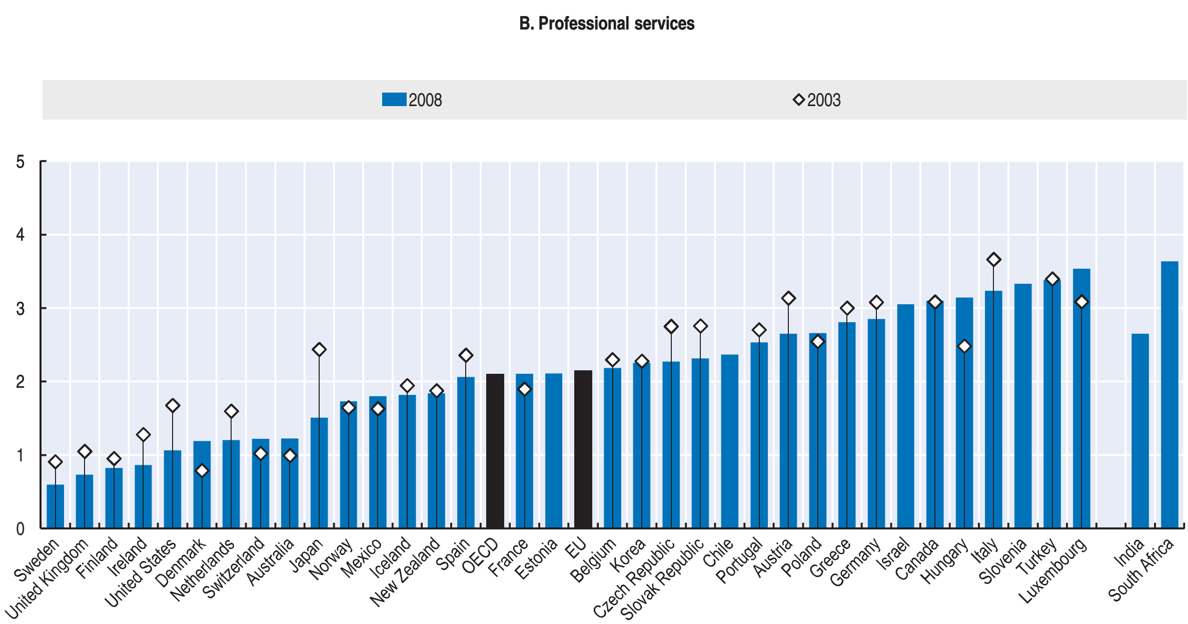
Source: OECD (2010), *Product Market Regulation Database*.

StatLink http://dx.doi.org/10.1787/888932373419

Figure 3.19. **Sectoral regulation in retail and professional services**

Index scale of 0-6 from least to most restrictive





Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

Source: OECD (2010), *Product Market Regulation Database*.

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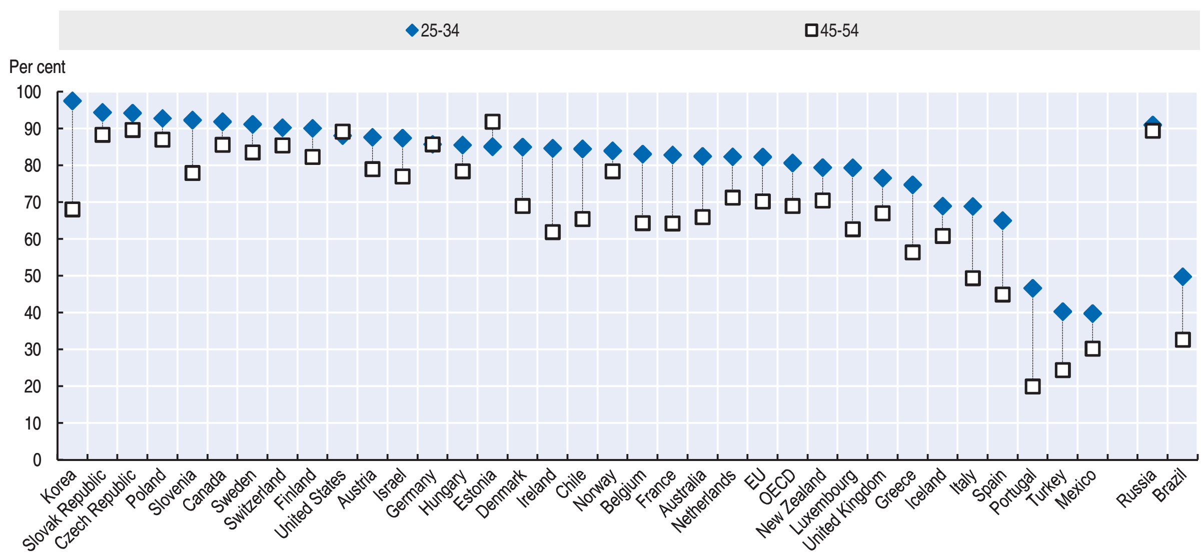
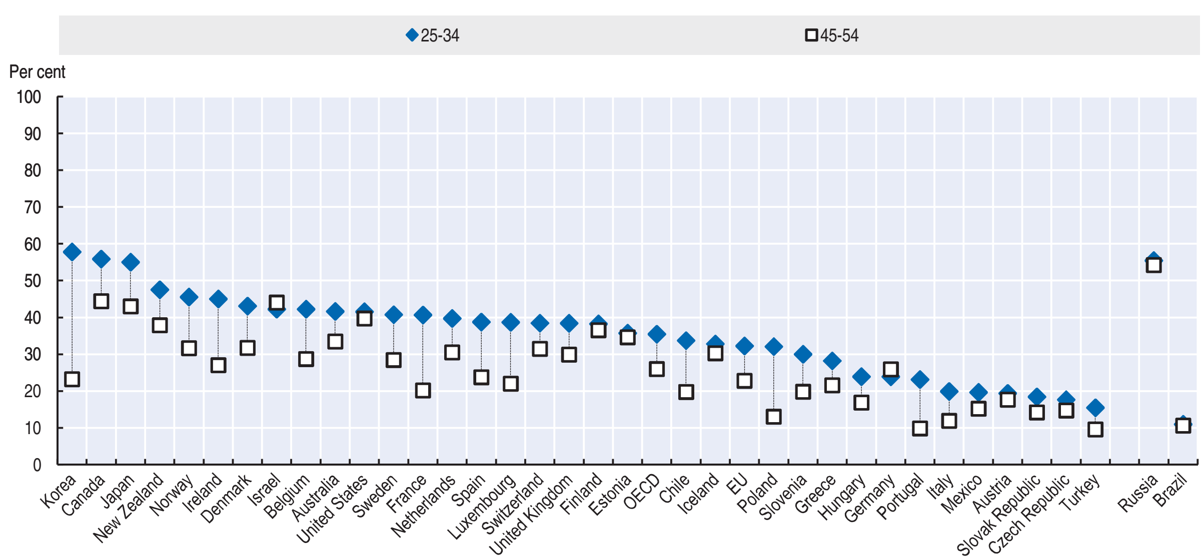
Figure 3.20. **Educational attainment, 2008**

Percentage of population aged 25-34 and 45-54

A. Upper secondary education



B. Tertiary education

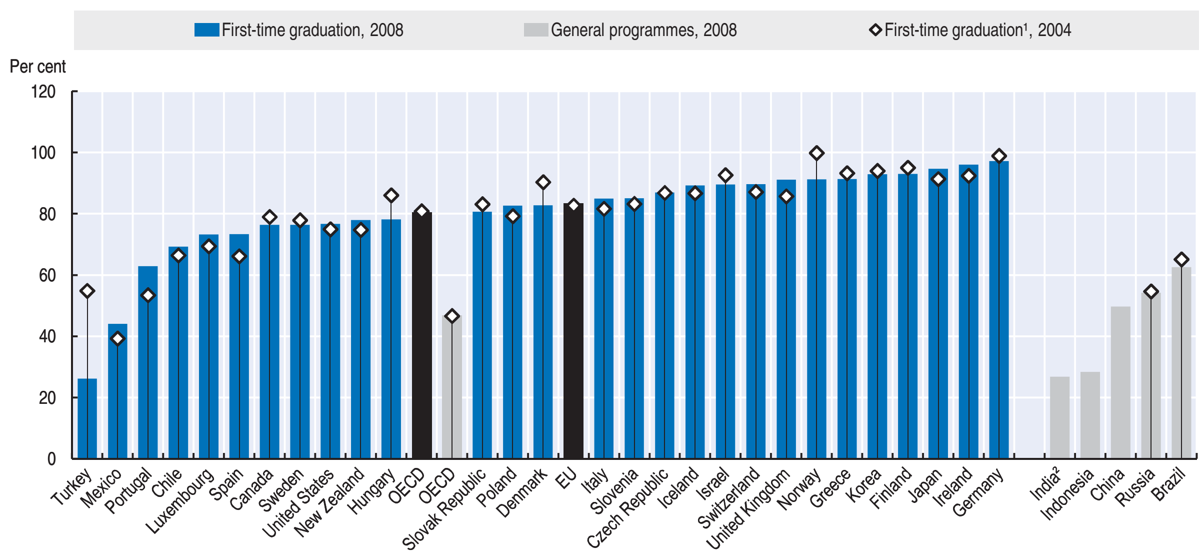


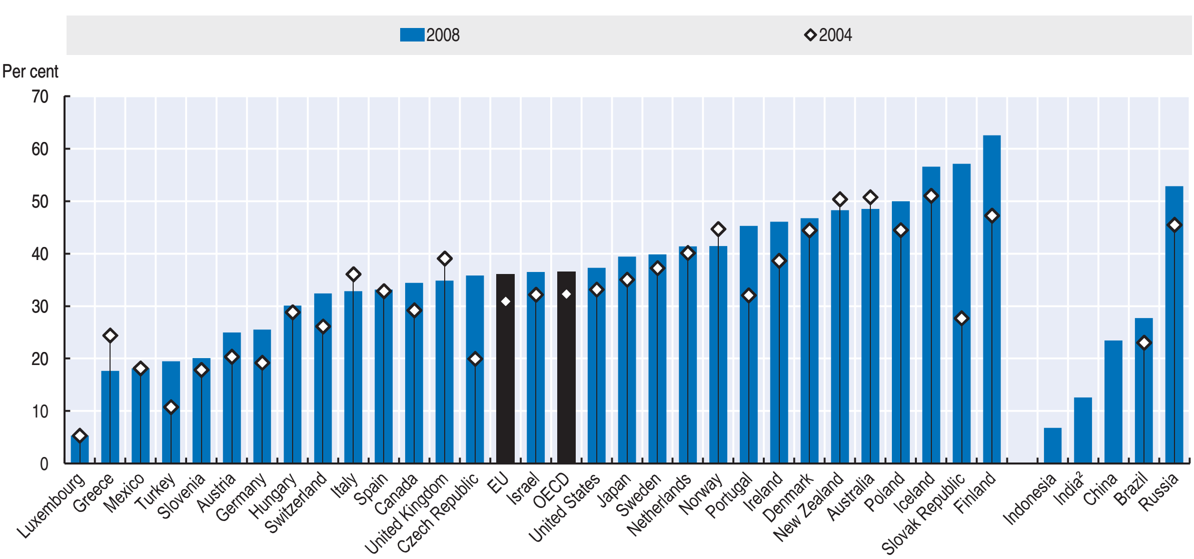
Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countriesr.

Source: OECD (2010), *Education at a Glance*.

StatLink http://dx.doi.org/10.1787/888932373457

Figure 3.21. **Graduation rates in upper secondary and tertiary education**





Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

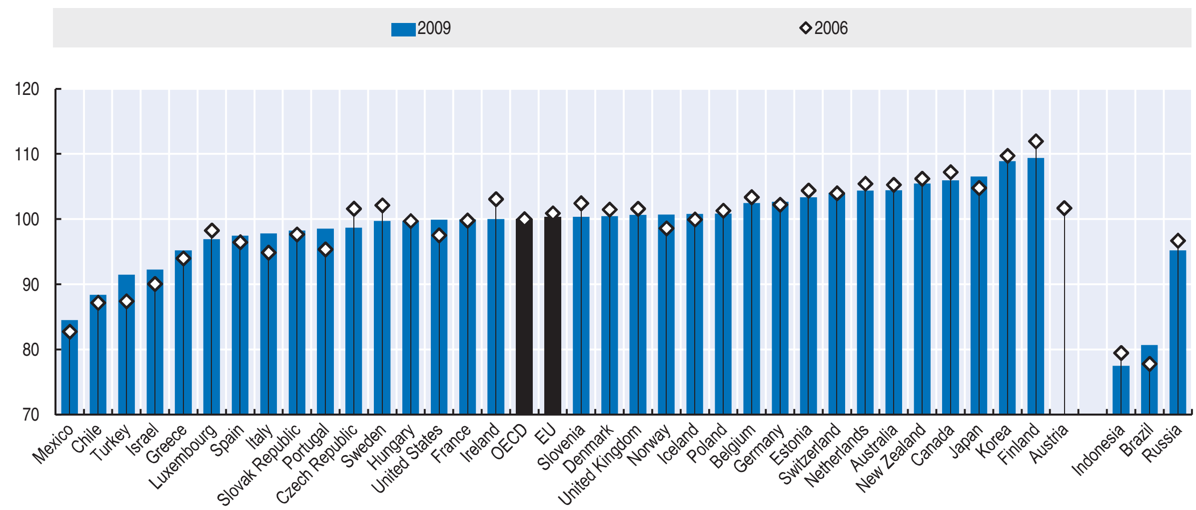
1. For Brazil and Russia, data for 2004 refer to general programmes.
2. Data for upper secondary education in India are defined as 19 years-old who completed upper secondary education. Data for tertiary education refer to the 24 years-old and over who got graduated.
3. Tertiary graduates are those who obtain a tertiary-type A qualification (ISCED 5A). For Brazil, Indonesia and Russia, data refer to first degree graduation in years 2006 and 2008.

Source: OECD (2010), *Education at a Glance; China Statistical Yearbook* and *India National Sample Survey* (2007/8).

StatLink http://dx.doi.org/10.1787/888932373476

Figure 3.22. **Educational achievement**

Average of PISA scores in reading, mathematics and science[1, 2]



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

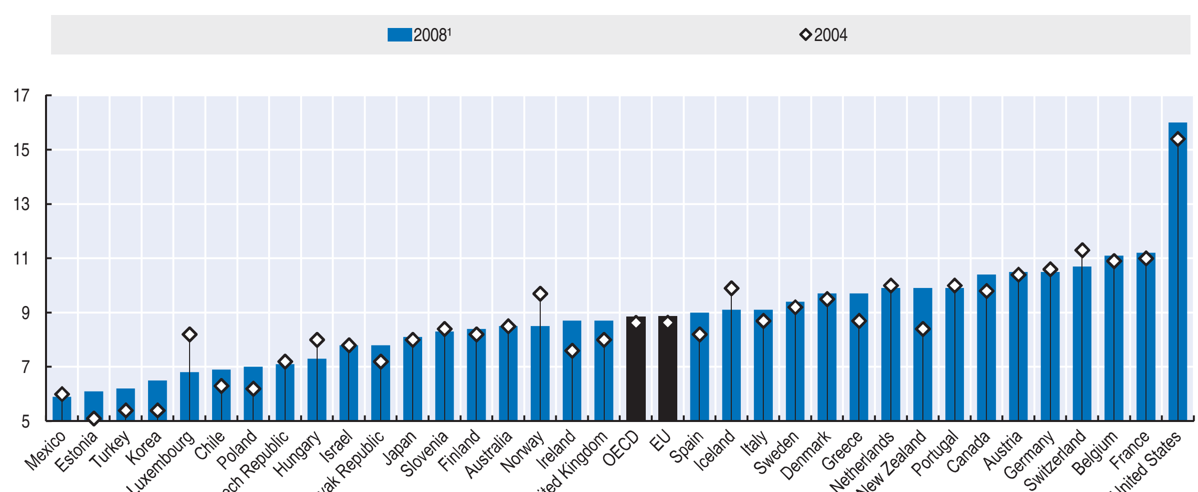
1. PISA is the Programme for International Student Assessment. OECD = 100.
2. For the United States, average of PISA scores in mathematics and science in 2006. Data for Austria is not available in 2009.

Source: OECD (2010), *PISA 2009 Database*.

StatLink http://dx.doi.org/10.1787/888932373495

Figure 3.23. **Health expenditure**

Percentage of GDP



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

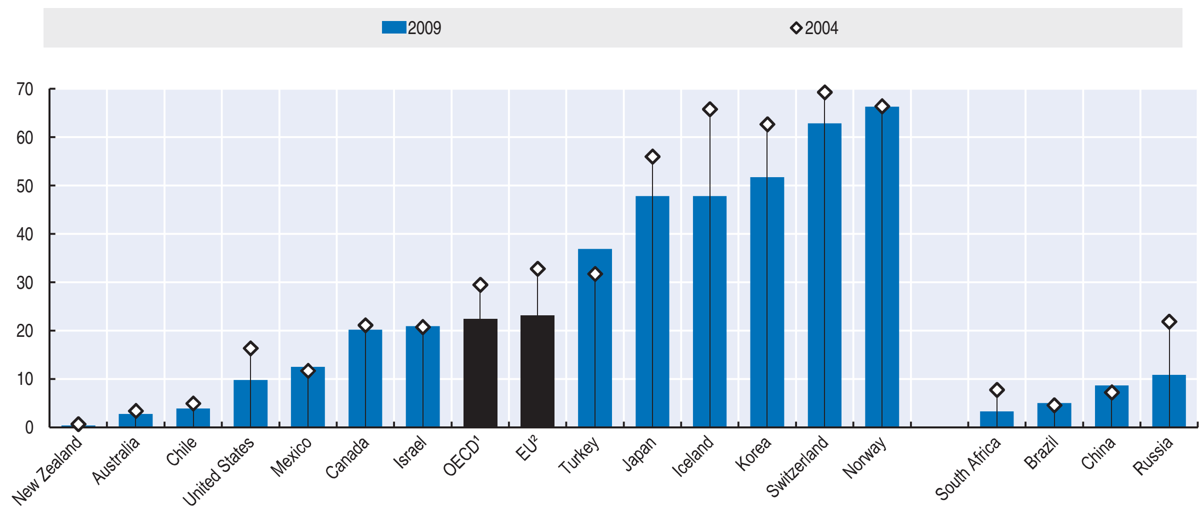
1. 2007 for Australia, Denmark, Greece and Japan; 2006 for Portugal.

Source: OECD (2010), *Health Database*.

StatLink http://dx.doi.org/10.1787/888932373514

Figure 3.24. **Producer support estimate to agriculture**

Percentage of farm receipts



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

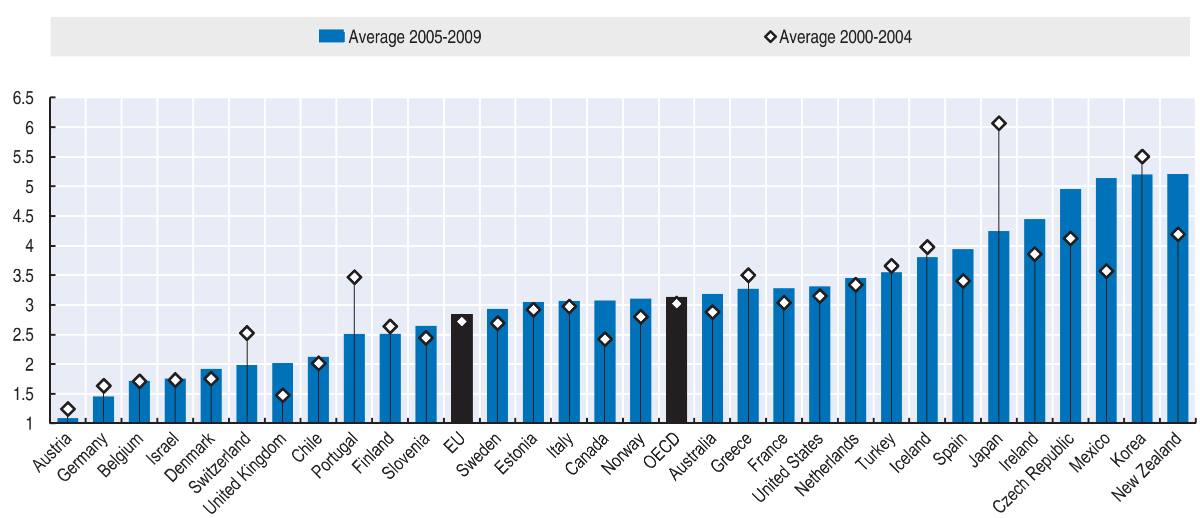
1. Average OECD countries excluding Chile, Estonia, Israel and Slovenia.
2. EU is the aggregate of European countries in the OECD excluding Estonia and Slovenia.

Source: OECD (2010), *Producer and Consumer Support Estimates Database.*

StatLink http://dx.doi.org/10.1787/888932373533

Figure 3.25. **Public investment**

Percentage of GDP



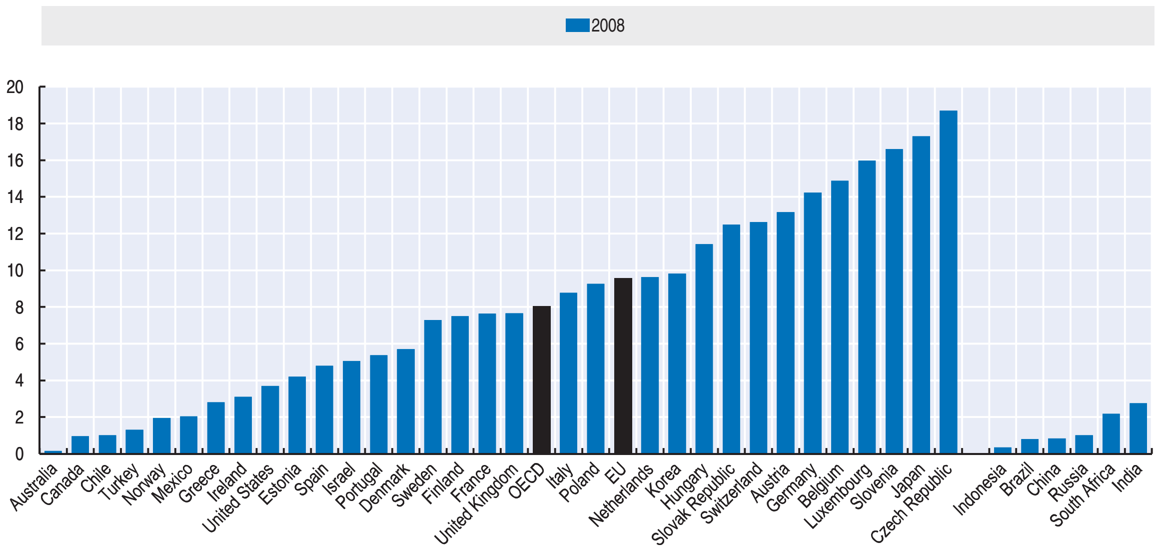
Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

Source: OECD (2010), *OECD Economic Outlook*, No. 88, Vol. 2010/2.

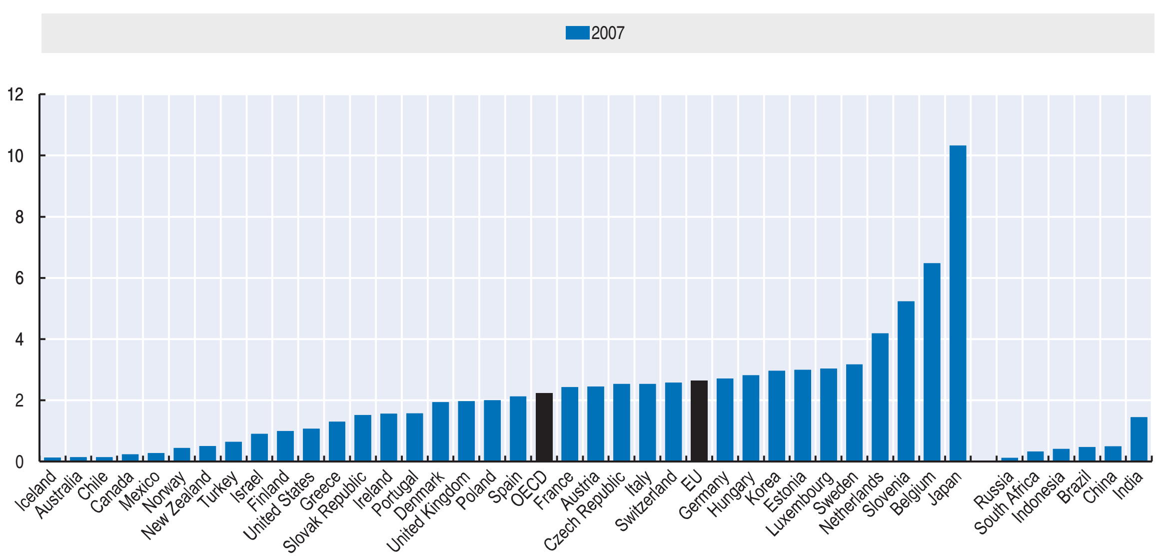
StatLink http://dx.doi.org/10.1787/888932373552

Figure 3.26. **Infrastructure**

A. Rail density
km per 100 km², less forest area



B. Road density
km per km², less forest area



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

Source: World Bank (2010), *World Development Indicators (WDI)*.

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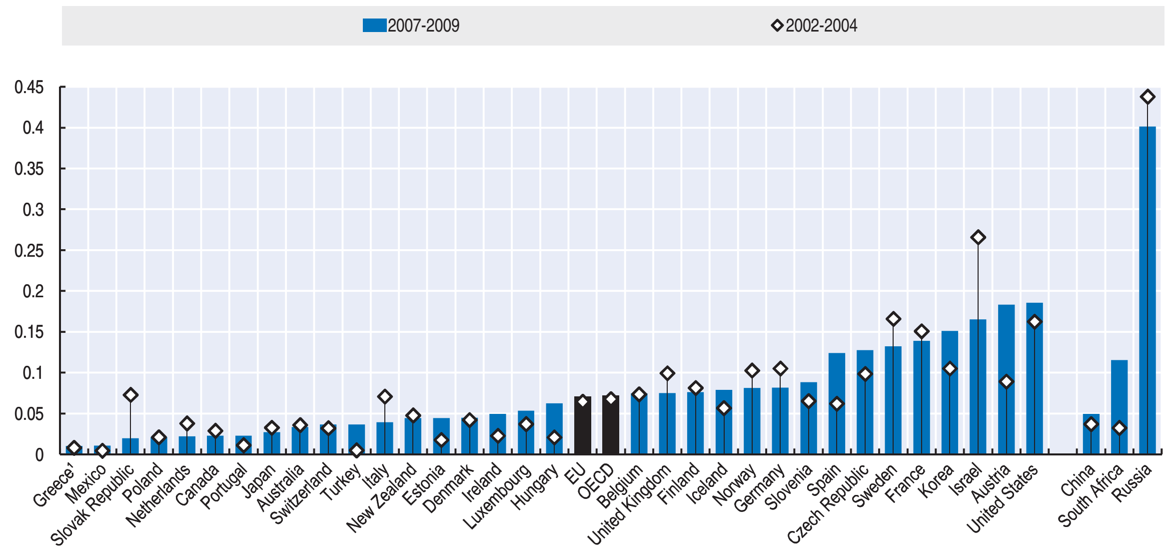
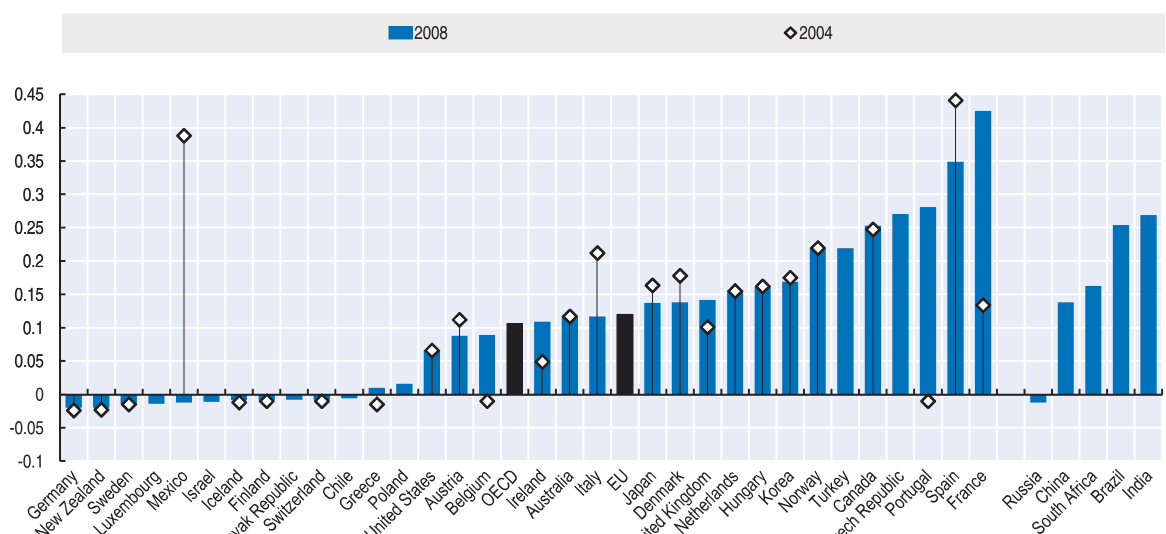
Figure 3.27. **Financial support for private R&D investment**

A. Direct public funding of business R&D
Percentage of GDP



B. Rate of tax subsidies for one dollar of R&D²



Note: Users of the data must be aware that they may no longer fully reflect the current situation in fast reforming countries.

1. Year 2005 for Greece.
2. Measures the generosity of tax incentives to invest in R&D, on the basis of the pre-tax income necessary to cover the initial cost of one dollar R&D spending and pay corporate taxes on one dollar of profit (B-index). A value of zero on the chart would mean that the tax concession for R&D spending is just sufficient to offset the impact of the corporate tax rate. Average over small and medium enterprises and large firms.

Source: Source: OECD (2010), *Science, Technology and R&D Statistics Database*; OECD (2009), *OECD Science, Technology and Industry Scoreboard*.

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PART II

Thematic Studies

Economic Policy Reforms 2011
Going for Growth

PART II

Chapter 4

Housing and the Economy: Policies for Renovation[1]

This chapter compares a number of housing policies for a range of OECD countries and concludes that badly-designed policies can have substantial negative effects on the economy, for instance by increasing the level and volatility of real house prices and preventing people from moving easily to follow employment opportunities. Some of these policies played an important role in triggering the recent financial and economic crisis and could also slow down the recovery. The chapter makes some recommendations for efficient and equitable housing policies that can also contribute to macroeconomic stability and growth.

Summary and conclusions

Badly-designed housing policies played an important role in triggering the recent economic and financial crisis. This chapter investigates how housing policies should be designed to ensure adequate housing for citizens, support growth in long-term living standards and strengthen macroeconomic stability.

Governments intervene in housing markets to enhance people's housing opportunities and to ensure equitable access to housing. These interventions include fiscal measures, such as taxes and subsidies; the direct provision of social housing or rent allowances; and various regulations influencing the quantity, quality and price of housing. Housing policies also have a bearing on overall economic performance and living standards, in that they can influence how households use their savings as well as residential and labour mobility, which is crucial for reallocating workers to new jobs and geographical areas. Indeed, as recent OECD analysis shows, effectively supervised financial and mortgage market development combined with policies that enhance housing supply flexibility are key for macroeconomic stability. The main conclusions of that analysis are summarised below, and each is then described in more detail in the remaining sections of this chapter:

- *Innovations in mortgage markets should be coupled with appropriate regulatory oversight and prudent banking regulations.* Financial liberalisation and mortgage innovations have increased access to credit and lowered the cost of housing finance. This has had positive implications for previously credit-constrained households, allowing them a better chance of owning their own home. But regulatory reforms in mortgage markets may also be behind a noticeable increase in house prices – by an average of 30% in OECD countries – and in house price volatility. Moreover, deregulation can pose risks for macroeconomic stability if it triggers a significant relaxation in lending standards and a subsequent increase in non-performing loans. This is why there is a need for regulatory oversight and prudent banking regulations.
- *Housing supply responsiveness to demand can be improved in many OECD countries, but care is needed to avoid volatility in residential housing investment.* Supply of new housing that is responsive to prices helps to avoid excessive volatility in house prices, but greater responsiveness can also translate into more volatile residential investment. Responsiveness can be increased by streamlining cumbersome construction licensing procedures, and – in countries with a shortage of land for residential construction – by encouraging the use of land through better linking the assessment of property value for tax purposes to the market value.
- *Housing policies can facilitate residential mobility, better match workers with jobs and help the labour market recover from the recent crisis.* For example:
  - Estimates suggest that increasing the responsiveness of housing supply from the low level that prevails in the Netherlands to the average OECD level would increase households' annual mobility rate by around 50%, possibly because a responsive supply evens out housing costs across regions.

- Easier access to credit is also associated with higher household mobility, because it provides access to more housing options and makes it easier to finance moving costs. However, high leverage rates can also pose risks to mobility as households with negative equity are often unable to move.[2]
- Easing the relatively strict rent controls and tenant-landlord regulations that are found in some Nordic and continental European countries could significantly increase residential mobility by improving the supply of rental housing and preventing the locking-in of tenants.
- Reducing the high costs involved with buying a residence that exist in some continental European countries could also enhance residential mobility. This would include tax restructuring and removing or curbing regulations that limit competition among intermediaries involved in housing transactions (*e.g.* notaries and real estate agencies).

● *Housing policies should be designed to be efficient and equitable:*

- Remove tax distortions by taxing housing and alternative investments in the same way; this implies taxing imputed rents and allowing mortgage interest to be tax deductible. Tax treatment of owner-occupied housing is often favourable relative to other forms of investment, notably due to the fact that imputed rental income is generally not taxed, while mortgage interest is often deductible. Such tax treatment can have undesirable consequences for the allocation of savings and investment in housing and in other markets. Moreover, tax breaks tend to be capitalised in house prices, thereby preventing some financially-constrained households from owning their home. Mortgage interest deductibility also tends to favour the better off, since the propensity to own a house rises with income. However, most countries do not tax imputed rent; using recurrent property taxes as a substitute is not sufficient as these taxes are not large enough to offset the mortgage subsidy. In such circumstances a "second best" approach could be either to remove mortgage interest relief or to scale up recurrent property taxes by levying them on cadastral values that are aligned with market values.
- Redesign regulations that bring rents far out of line with market values or tilt the balance of tenant-landlord relations disproportionally in favour of either party. Strict rental regulations are associated with lower quantity and quality of housing and their benefits for tenants are not certain. Indeed there is no clear evidence that average rents in countries with stricter controls are lower. Moreover, especially if they are poorly targeted, rental market regulations may have undesirable redistributive effects among different categories of tenants.
- Use carefully-designed, targeted social housing systems and portable rent allowances to ensure housing for low-income households. Social housing systems which are directed to those most in need seem able to achieve their goals at a lower cost than less targeted systems, although they need to be carefully designed to avoid any adverse implications for social mix, mobility and associated labour market outcomes. Well-designed portable housing allowances may be preferable to the direct provision of social housing as they do not seem to directly hinder residential mobility.

Housing policies and recent housing market developments

The extreme developments in housing markets were a key feature of the current economic crisis and the run up to it (*e.g.* OECD, 2010). In many OECD countries, the general increase in real house prices since the mid-1980s (Table 4.1)[3] came to an abrupt halt immediately before or as the crisis began (André, 2010). Large corrections in house prices in many countries reduced households' wealth and consumption, as well as residential investment. New OECD analysis shows that past developments in real house prices and residential construction were not only affected by macroeconomic factors such as income and interest rates, but also by structural features and policies in housing and housing finance markets. These shaped the size and pattern of housing demand shocks, the responsiveness of supply and consequently overall residential construction and price patterns. This section explores these policies and their impacts.

Table 4.1. **Changes in real house prices across OECD countries**[1]

1980 (or earliest year available)-2008

Very large increases (90% or more)	Moderate to large increases (20% to 90%)	Stable or declining (less than 20% increase)
Australia	Austria	Chile
Belgium	Canada	Germany
Finland	Denmark	Hungary
Ireland	France	Israel
Netherlands	Greece	Japan
New Zealand	Italy	Korea
Norway	Slovenia	Portugal
Spain	Sweden	Switzerland
United Kingdom	United States	

1. Nominal prices deflated by the consumer price index.
Source: National statistical offices and OECD (2010), *OECD Economic Outlook: Statistics and Projections Database*.

Financial market liberalisation eased access to credit and increased owner-occupancy among credit-constrained households

Housing finance markets have changed drastically over recent decades, reflecting a wave of financial reforms motivated by broader economic efficiency goals. Liberalisation significantly expands borrowing opportunities and lowers borrowing costs for housing, resulting in a substantial expansion in the supply of mortgage loans in many countries (ECB, 2009; Ellis, 2006). One key development has been the significant reduction in down payment requirements, enabling households to rely more on debt to finance housing investment. Requirements for high down payments tend to negatively affect lower income consumers and particularly younger households, who often have had less time to accumulate the necessary capital for a deposit. One measure of this down payment constraint is the maximum loan-to-value ratio – the maximum permitted value of the loan as a share of the market price of the property.[4] Estimates suggest that a 10 percentage point decrease in the maximum loan-to-value ratio is associated with a 12% rise in the home ownership rate among younger low-income households (*i.e.* owners aged 25-34 years in the second income quartile).[5]

The links between deregulation, house prices and house price volatility

The expansion in the availability of credit has increased housing demand and real house prices in many countries. Financial deregulation is estimated to have increased real house prices by as much as 30% in the average OECD country over 1980 to 2005. On the one hand, more competitive mortgage markets with more diverse funding sources, lenders and loan products are likely to strengthen economic resilience by facilitating housing equity withdrawal.[6] On the other hand, they also make it easier for investors to borrow to buy homes, which may make house prices more volatile. In fact, increases in permissible leverage (measured by the maximum loan-to-value ratio) tend to exacerbate real house price volatility in a large sample of OECD countries (Table 4.2). Greater house price volatility in turn can decrease macroeconomic stability and income certainty for households. It can also raise systemic risks as the banking and mortgage sectors are vulnerable to fluctuations in house prices due to their exposure to the housing market.

Table 4.2. **The effect of policies on reducing real house price volatility**[1]

Real house price volatility can be reduced by…	Policy experiment
25%	A further improvement in banking supervision equivalent to that observed on average in OECD over the 1990-2005 period (based on an index sourced from Abiad *et al.* 2008).
20%	Reducing the maximum loan-to-value ratio by 10 percentage points.[2]
19%	Increasing the estimated supply elasticity from the level observed in Ireland to the level in Canada (see Figure 4.1).
11%	Reducing the tax relief on mortgage debt financing costs from the level observed in Netherlands to the level in Sweden (see Figure 4.7).

1. The policy experiments are roughly equivalent to the impact of a one standard deviation change in the policy variables of interest on real house price volatility. Estimates are based on random effects panel regressions for between 16 and 20 OECD countries, over the period *circa* 1980-2005. The dependent variable is the standard deviation in annual real house price growth and the model also controls for macroeconomic volatility and time fixed effects (see Andrews (2010) for details).
2. Over the sample period, loan-to-value ratios range from a minimum of 56% to a maximum of 110% in OECD countries.

Source: Abiad, A., E. Detragiache and T. Tressel (2008), "A New Database of Financial Reforms", *IMF Working Paper,* No. 08, Vol. 266, International Monetary Fund; Andrews, D. (2010), "Real House Prices in OECD Countries – The Role of Demand Shocks and Structural and Policy Factors", *OECD Economics Department Working Papers,* No. 831.

The link between banking supervision and house price volatility

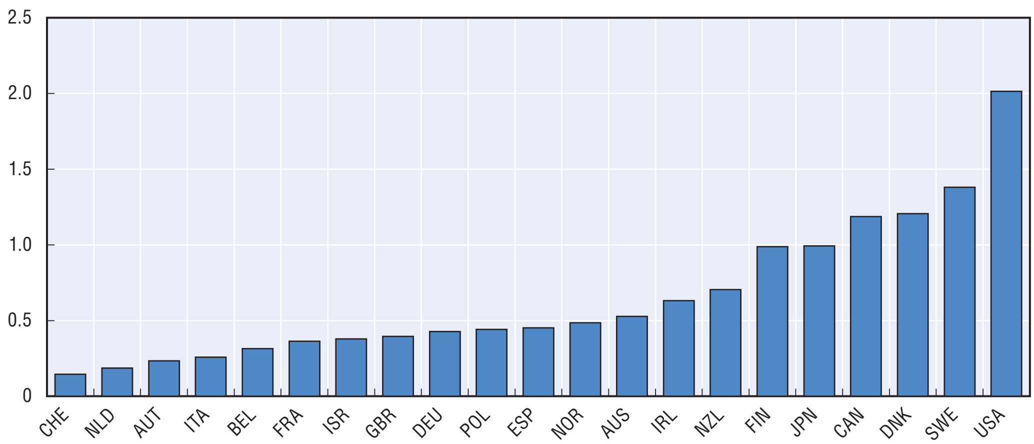
Inadequate banking supervision and, in turn, poorly underwritten residential mortgage contracts played a significant role in the run up to the recent financial crisis, which was characterised by a noticeable increase in house price variability. While easing credit constraints is generally desirable, in the absence of adequate regulatory oversight, policy changes that trigger a relaxation in lending standards can increase non-performing loans (*i.e.* loan that is in default or close to being in default), thereby jeopardising macroeconomic stability. For instance, lending standards in the United States were significantly relaxed during the housing boom: in 2001, only 8% of home purchasers had a down payment of zero, but by 2007 this figure had risen to 22% (US Census Bureau, 2007).[7] The OECD estimates that the quality of banking supervision can have a large impact on house price volatility. For the average OECD country, a further improvement in supervisory arrangements equivalent to that observed over the 1990-2005 period could reduce real house price volatility by around 25%, all other things being equal (Table 4.2).[8]

House prices increase more where housing supply is slow to respond to demand

The price responsiveness of new housing investment determines the extent to which increases in demand for housing, for instance following easier access to credit, result in higher prices rather than in more housing investment. According to OECD estimates, the long-run price responsiveness of new housing supply tends to be relatively strong in North America and some Nordic countries, while it is weaker in continental European countries and the United Kingdom (Figure 4.1; Caldera Sánchez and Johansson, 2011).

Figure 4.1. **Variations in responsiveness of new housing supply to prices, selected OECD countries**

Estimates of the long-run price-elasticity of new housing supply[1]



1. Estimates of the long-run price elasticity of new housing supply where new supply is measured by residential investments. All elasticities are significant at least at the 10% level. A greater number indicates a more responsive supply. In the case of Spain, restricting the sample to the period 1995-2007, which would reflect recent developments in housing markets (such as the large stock of unsold houses resulting from the construction boom starting in 2000 and peaking in 2007-09), only slightly increases the estimate of the elasticity of housing supply from 0.45 to 0.58. Estimation period early 1980s to mid-2000s.

Source: Caldera Sánchez, A. and Å. Johansson (2011), "The Price Responsiveness of Housing Supply in OECD Countries", *OECD Economics Department Working Papers*, No. 837.

StatLink http://dx.doi.org/10.1787/888932368669

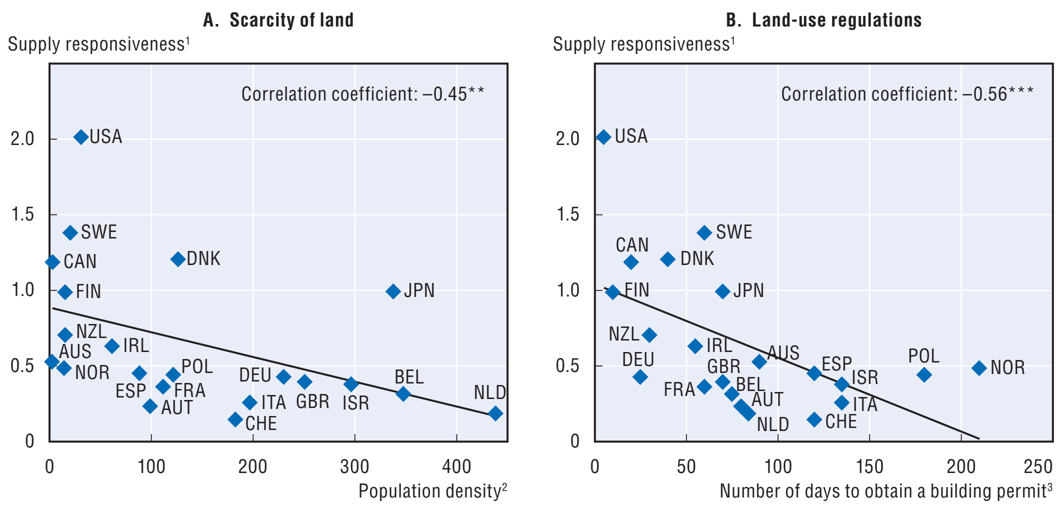
In the short to medium term, an increase in housing demand (*e.g.* caused by mortgage market deregulation, higher levels of activity and employment or migration inflows) would translate into smaller increases in real house prices if housing supply is more responsive. Responsive housing supply is especially important to avoid bottlenecks in different segments of the market. However, the flip side is that in flexible-supply countries, housing investment adjusts more rapidly to large changes in demand. This contributes to more cyclical swings in economic growth, as witnessed by recent developments.

Despite this trade-off, in the longer term a more flexible supply of housing is generally desirable as it allows a better match of housing construction to changes in housing demand patterns across the territory. Estimates show that the influence of supply responsiveness on the reaction to housing demand shocks is likely to be large, all else being equal. For example, if the responsiveness of new supply is reduced from the relatively high level estimated for Japan to the level in New Zealand (see Figure 4.1), the increase in house prices associated with a given increase in demand is at least 50% larger (Andrews, 2010). During recent decades very large price increases were observed in the United Kingdom and the Netherlands – in these two countries the responsiveness of new housing supply to housing prices is noticeably low (Figure 4.1). By contrast, other countries where supply tends to be more flexible, such as the United States, experienced more moderate price increases. Estimates also show that house prices are more volatile where housing supply is rigid, because variations in demand translate more fully into changes in prices (Table 4.2).

How can public policies affect supply responsiveness?

Housing supply may be constrained by both policy and non-policy factors. Geographical and demographic conditions – such as physical limitations on land for development and the degree of urbanisation – can restrict housing supply in certain areas. Indeed housing supply responsiveness tends to decrease as population density increases (Figure 4.2, Panel A). But public policies also play a role *via* land-use and planning or rental regulations, with new housing supply responsiveness tending to be lower in countries where it takes longer to acquire a building permit (Figure 4.2, Panel B).

Figure 4.2. **Supply responsiveness is weaker where land is scarce and land-use regulations cumbersome**



1. OECD estimates of country-specific supply responsiveness.
2. Population density measured as population per km^2.
3. The number of days to obtain a building permit is obtained from the *World Bank Doing Business Database*.

*** denotes statistical significance at 1% and ** at 5% confidence level.

Source: OECD estimations based on Caldera Sánchez, A. and Å. Johansson (2011), "The Price Responsiveness of Housing Supply in OECD Countries", *OECD Economics Department Working Papers*, No. 837; United Nations (2007), *Demographic and Social Statistics Database*; World Bank (2009), *World Bank Doing Business Database*.

StatLink http://dx.doi.org/10.1787/888932368688

Housing supply can be made more responsive by designing and enforcing efficient land-use regulations, such as streamlining complicated construction licensing procedures and easing planning restrictions on multi-family construction (typically dwellings for rent) in order to increase the supply of private rental housing (Schuetz, 2007). Apart from improving land-use regulations, providing infrastructure and other public services along with housing – such as road junctions or water drainage – is also likely to influence supply (*e.g.* Barker, 2008). Moreover, well-designed taxes on vacant properties and undeveloped land can encourage the appropriate use of land for residential and business property in urban areas. For instance, linking the assessment of property value for tax purposes to the market value may increase incentives for developing vacant land as market prices also reflect its development potential (OECD, 2009).

Housing policies, residential mobility and labour market dynamism

In the recovery from the current economic downturn, the ability of workers to move to expanding sectors and regions is crucial if countries are to return gradually to pre-crisis employment rates. Residential and labour mobility is a key ingredient in this adjustment process. In the OECD, on average around 6%[9] of households move residence every year. However, such residential mobility is lower in southern and eastern European countries than in English-speaking and Nordic countries, where households move twice as much (Figure 4.3, Panel A). In addition, there is also a link between residential mobility and reallocation of workers (Figure 4.3, Panel B). This suggests that residential mobility can make it easier for the labour force to adjust to changing employment availability, possibly speeding up the transition out of the current high rates of unemployment. These links between housing, mobility and the labour market are explored further in this section.

Home ownership and social housing tend to reduce mobility

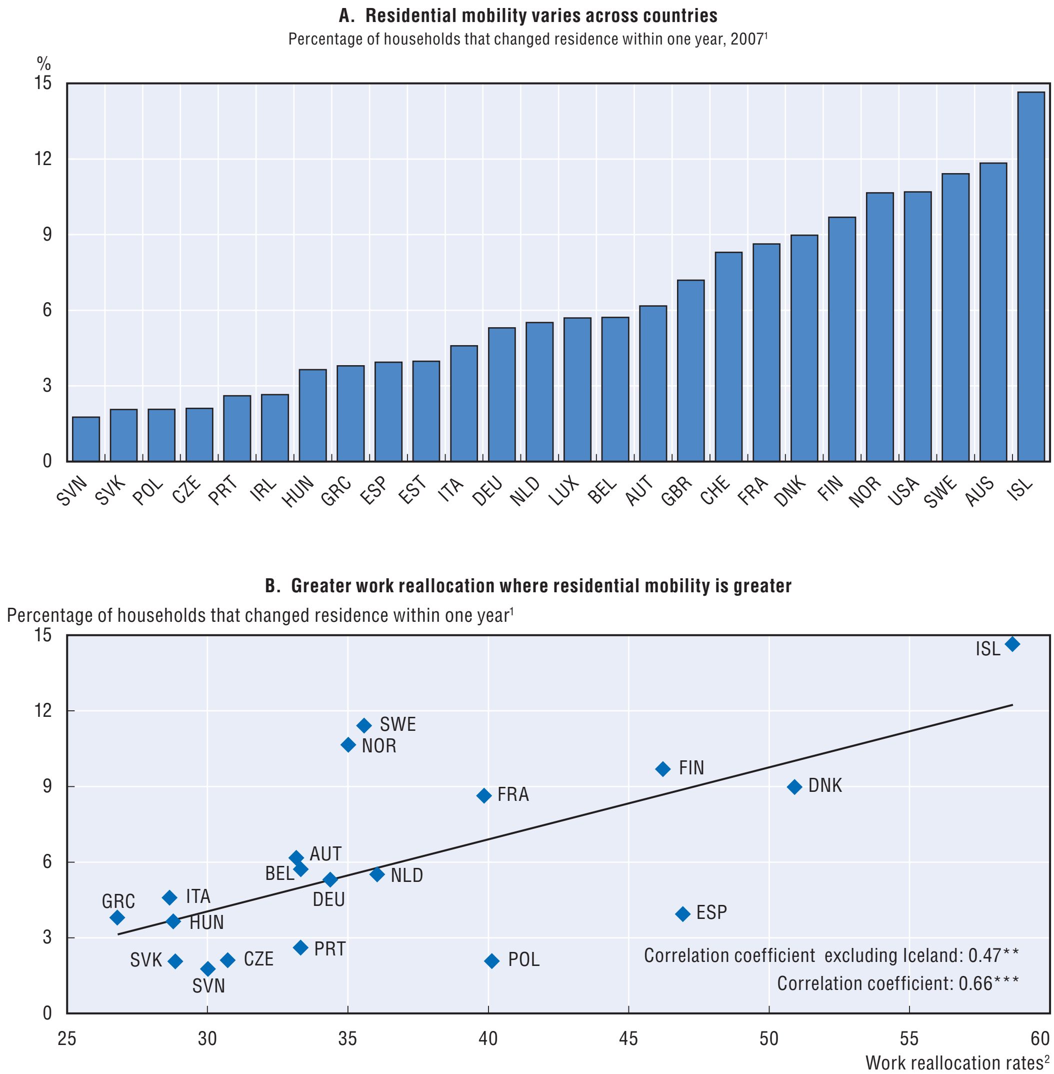
The type of housing tenure has an influence on mobility rates. OECD analysis shows that home owners tend to be less mobile than private renters, even after taking into account other household characteristics (*e.g.* age and income, and marital, migrant and employment status, etc.). This lower mobility among owner-occupants than renters is likely to be because owners face higher transaction costs when moving house. They thus tend to move house less often in order to spread these costs over a longer time period (*e.g.* Oswald, 1996; Coulson and Fisher, 2009). On average, an owner without a mortgage is estimated to be 13% less likely to move every year than a private renter, while a mortgage owner's yearly mobility rate is some 9% lower than that of a renter.[10] What explains the greater mobility rate among owners with a mortgage compared to those without a mortgage? This may reflect the fact that home owners with a mortgage have greater incentives to remain employed and/or to become re-employed more quickly because of their need to repay their mortgage. They would therefore try to reduce periods of unemployment by accepting jobs even if it requires moving residence (Flatau *et al.,* 2003).

Tenants in social housing are on average 6% less likely than private tenants to move every year. This is perhaps because they are reluctant to give up below-market rents and tenancies which are generally more secure (*e.g.* Menard and Sellem, 2010; Flatau *et al.,* 2003; Hughes and McCormick, 1981; 1985). This is particularly the case in Australia, France and the United Kingdom, which may possibly reflect that in these countries social housing is highly targeted to those who need it most (see below). Housing allowances do not seem to hinder residential and labour mobility to the same extent as direct provision of social housing, especially if they are portable (ECB, 2003; Hughes and McCormick, 1981; 1985). An additional advantage of housing allowances over direct housing provision is that in a majority of countries households can receive rent allowances for any rental dwelling, *i.e.* both social and private rental, which makes them more portable and further increases residential mobility.

Increasing mobility by making housing supply more responsive and lowering house purchase transaction costs

An unresponsive supply reduces the availability of housing and can contribute to regional price differentials and housing market imbalances – other factors in reducing residential mobility. Large price differentials between areas, for instance caused by rapid changes in housing demand within a region combined with rigid housing supply, can

Figure 4.3. **Residential and labour mobility are important for the functioning of labour markets**



1. Mobility rates are annualised. The low mobility rate in some Eastern European countries (*e.g.* 2% in Slovenia implying a move every 50 years) does not seem reasonable and may reflect problems with the underlying data. However, this is difficult to verify as there is no alternative data source.
2. Work reallocation rates are country averages of reallocation rates (hiring and firing rates) expressed in percentage of total dependent employment. See *OECD Employment Outlook* (2010).

*** denotes statistical significance at 1% and ** at 5% confidence level.

Source: OECD calculations based on the following 2007 databases: European Commission (2007), Eurostat EU-SILC Database; Melbourne Institute (2007), The Household, Income and Labour Dynamics in Australia (HILDA) Survey; Swiss Foundation for Research in the Social Sciences (2007), Swiss Household Panel (SHP); US Census Bureau (2007), American Housing Survey (AHS); OECD (2010), *OECD Employment Outlook 2010: Moving beyond the Jobs Crisis.*

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reduce geographical mobility. This is because households in cheaper areas have to secure greater credit if they wish to move to the higher-priced region (Saks, 2008; Barker, 2004; Cameron and Muellbauer, 1998). In countries with a more responsive supply of new housing, residential mobility tends to be much higher. For example, increasing the responsiveness of supply from the Netherlands' low level (Figure 4.1) to the OECD average would raise the household annual mobility rate by around 2.3 percentage points all else being equal (Table 4.3).

Table 4.3. **How policies can increase residential mobility**[1]

The probability of moving each year can be increased by…	Policy experiments
2.3 percentage points…	Increasing the estimated price-elasticity of housing supply from the level in the Netherlands to the average level in the OECD (see Figure 4.1).
1.4 percentage points…	Decreasing the rent control from the level in Germany to the average level in the OECD (see Figure 4.5).
1.4 percentage points…	Decreasing the down-payment constraint (*i.e.* increasing the loan-to-value ratio) by 20 percentage points from the level in Switzerland to the average level in the OECD.
1.1 percentage points…	Increasing access to credit (*i.e.* increasing the share of private credit to GDP) from the level in the Slovak Republic to the average level in the OECD.
0.6 percentage points…	Decreasing tenure security (*i.e.* tenant-landlord regulations) from the level in Portugal to the average level in the OECD (see Figure 4.5).
0.5 percentage points…	Decreasing transaction costs from the level in Greece to the average level in the OECD (see Figure 4.4).

Memorandum item: Average annual probability to move in OECD countries = 6%.

1. Policy experiments are roughly equivalent to the impact of a one and a half standard deviation change in the policy variables of interest on residential mobility. Estimates based on probit regression of household probability to move controlling for age, tenure status, education, employment, income and squared income, cohabitation status, total income and the national urbanisation rate.

Source: OECD calculations based on the following databases: European Commission (2007), Eurostat EU-SILC Database; Melbourne Institute (2007), The Household, Income and Labour Dynamics in Australia (HILDA) Survey; Swiss Foundation for Research in the Social Sciences (2007), Swiss Household Panel (SHP); US Census Bureau (2007), American Housing Survey (AHS); Caldera Sánchez, A. and D. Andrews (2011), "To Move or Not to Move: What Drives Residential Mobility Rates in the OECD?", *OECD Economics Department Working Papers,* No. 846.

The costs involved in buying and selling houses can also reduce residential and labour mobility (Oswald, 1996; 1999; Haurin and Gill, 2002; van Ommeren and Leuvensteijn, 2005). Housing transaction costs differ considerably across OECD countries, ranging from at least 14% of property value in Belgium, France and Greece to less than 4% in Denmark and Iceland (Figure 4.4). These costs include a number of different types of costs and fees, such as transfer taxes (*e.g.* stamp duties, acquisition taxes etc.), fees incurred when registering the property in the land registry, notary or other legal fees, and real estate agency fees.[11]

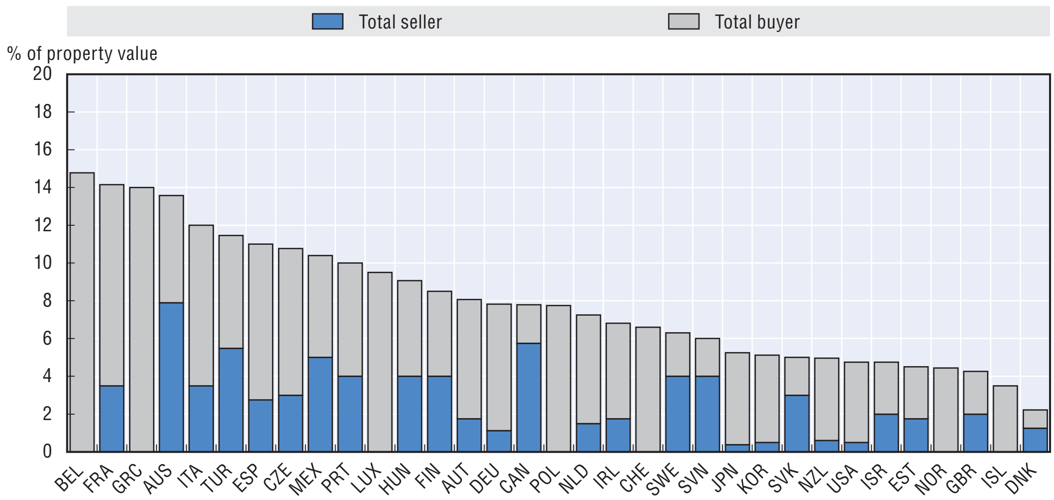
In some cases, the fees paid to intermediaries can be set directly by government regulations (or by government-backed self regulations of the profession) or be influenced by legal barriers to entry into some markets (*e.g.* notarial real estate services). OECD estimates show that higher costs in property purchase are associated with lower residential mobility. For example, reducing transaction costs from the high level observed in Greece (Figure 4.4) to the average level among the countries included in the study would increase the annual probability of moving by around 0.5 percentage points (Table 4.3). In addition, transaction taxes are inefficient for raising revenue as the same tax revenue could in principle be obtained at a lower economic cost by taxing consumption instead (OECD, 2009). Policies can contribute to reduce these one-off costs by tax restructuring and/or lifting barriers to entry in the relevant professions, particularly where costs are excessively high and are likely to significantly reduce residential mobility, such as in Belgium, France, Greece and Italy.

Increasing mobility by relaxing rental regulations

Rental markets are influenced by a range of regulations covering rents and tenant-landlord relationships. Rent control is comparatively strict in countries with a relatively large rental sector (*e.g.* the Czech Republic, Germany, the Netherlands and Sweden) (Figure 4.5, Panel A; and Johansson, 2011). While the causality is unclear, this might be explained by the fact that in countries with a larger rental sector there is more widespread

Figure 4.4. **How the transaction costs of purchasing property vary across OECD countries,[1] 2009**

Transaction costs for buyer and seller



1. Transaction costs refer to average costs. The estimates do not take into account the various tax breaks that exist in countries for certain dwellings implying that the estimated cost may overestimate the actual cost in some countries (for example in Italy) where such tax breaks are frequent. In addition, VAT when applied to certain costs is not included due to data limitations.

Source: Johansson, Å. (2011), "Housing Policies in OECD Countries: Survey-based Data and Implications", *OECD Economics Department Working Papers*, forthcoming.

StatLink http://dx.doi.org/10.1787/888932368726

demand for regulations governing its functioning. By contrast, rent control is lax in Finland, New Zealand, Slovenia, the United Kingdom and the United States. Most countries also regulate contractual aspects of tenant-landlord relations – such regulations tend to be comparatively strict in many continental European countries (Figure 4.5, Panel B), often going along with comparatively more stringent rent controls. One probable explanation is that if rent control is not coupled with security of tenure, in regimes where sitting tenants receive relatively more protection against rent increases landlords may have an incentive to evict tenants in order to raise rents (Arnott, 2003; Ellingsen and Englund, 2003).

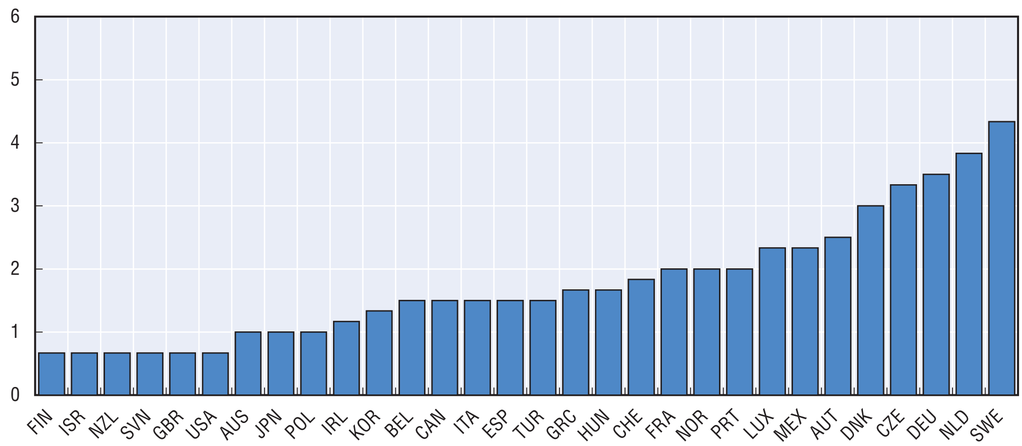
Strict regulations in rental markets can reduce residential mobility as tenants in rent-controlled dwellings will be reluctant to move if rents are below market levels and tenure security is greater than in the unregulated segment (*e.g.* Lind, 2001; Nagy, 1997; Ball, 2009). Similarly, strict tenant-landlord regulation resulting in high tenure security can lower the expected returns from residential rental supply, thereby reducing investment or encouraging hoarding or alternative uses of the existing stock by owners. Together, the negative effects of excessive rental regulation on supply and tenants' incentives to move may reduce turnover in the rental sector and lower residential mobility.

How can policies governing the rental market increase mobility? OECD analysis shows that residential mobility in countries with relatively strict rental regulation (measured in terms of both rent control and tenure security) is significantly lower than elsewhere. For example, reducing rent control from the high level observed in Germany (Figure 4.5, Panel A) to the average level among the countries included in the study would increase the annual mobility rate by around 1.4 percentage points (Table 4.3). In order not to deter mobility, regulations should also be harmonised across different segments of the housing

Figure 4.5. **Rental regulations compared, selected OECD countries, 2009**

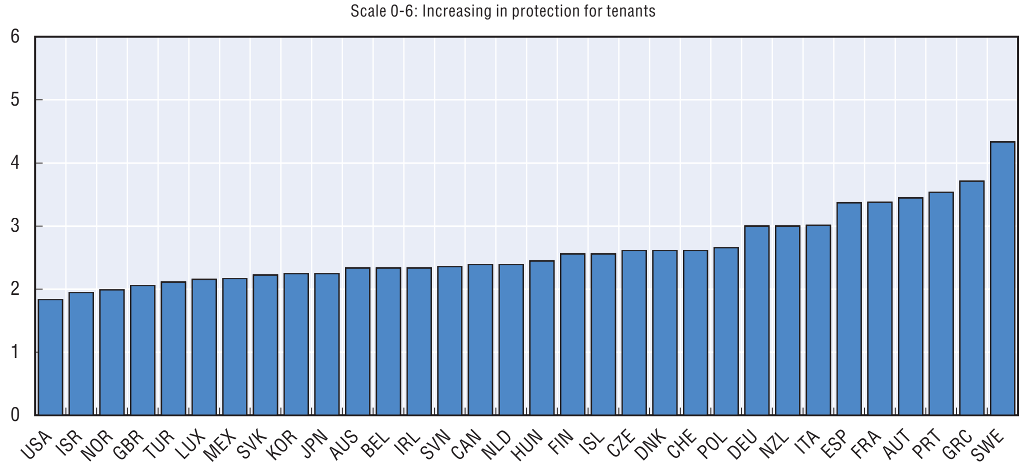
A. Rent control in the private rental market,[1] 2009

Scale 0-6: Increasing in degree of control



B. Tenant-landlord regulations in the private rental market,[2] 2009

Scale 0-6: Increasing in protection for tenants



1. This indicator is a composite indicator of the extent of controls of rents, how increases in rents are determined and the permitted cost pass-through onto rents in each country. Control of rent levels includes information on whether rent levels can be freely negotiated between the landlord and the tenant, coverage of controls on rent levels and the criteria for setting rent levels (market based, utility/cost based, negotiation based or income based). Controls of rent increases includes information on whether rent increases can be freely agreed by the landlord/tenant, whether rent increases are regularly indexed to some cost/price index or if increases are capped or determined through some other administrative procedure, including negotiation between tenant/landlord associations. The pass-through of costs onto rents includes information on whether landlords are allowed to pass on increases in costs onto rents (cost pass-through) and the extent of such pass-through *i.e.* the types of cost that can be passed on.
2. The indicator measures the extent of tenant-landlord regulation within a tenancy. It includes the ease of evicting a tenant, degree of tenure security and deposit requirements.

Source: Johansson, Å. (2011), "Housing Policies in OECD Countries: Survey-based Data and Implications", *OECD Economics Department Working Papers*, forthcoming.

StatLink http://dx.doi.org/10.1787/888932368745

market, including social and private rentals, and consideration should be given to easing stringent rental regulations. For example, because rent regulations in social housing tend to be stricter than in the private sector, this may discourage mobility among social tenants because moving into the private market could reduce their rent and tenure advantages (Flatau *et al.*, 2003).

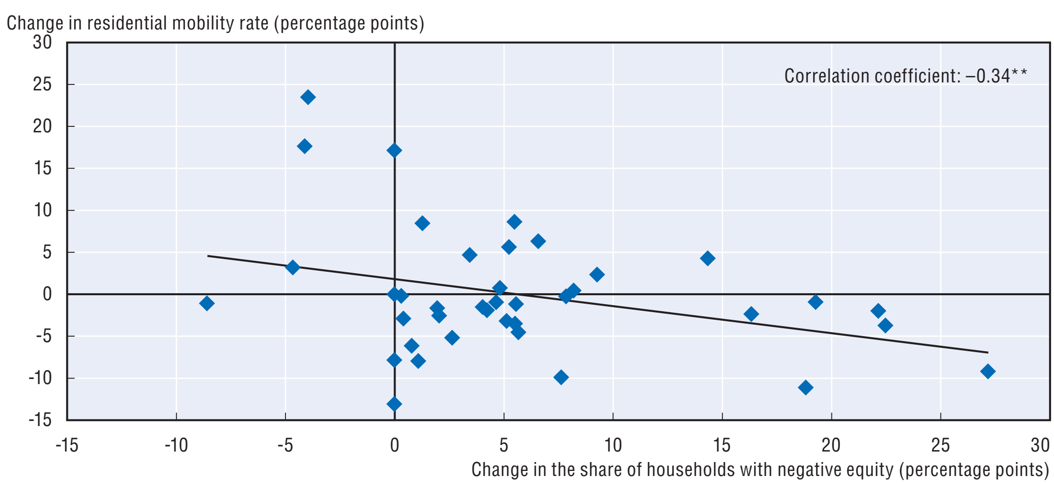
Increasing mobility by allowing greater access to credit, but avoiding high leverage

Since changing residence involves financial costs, reducing the cost of credit and making it easier to access can aid mobility. This is confirmed by OECD evidence that easier access to credit (represented by the share of private credit in gross domestic product – GDP) and lower down-payment requirements (represented by higher maximum loan-to-value ratios) are associated with higher residential mobility (Table 4.3). This effect is particularly pronounced for younger households, possibly reflecting the fact that they have had less time to accumulate savings to pay for the costs of changing residence.

However, high leverage ratios can potentially undermine mobility (Ferreira *et al.,* 2008). If house prices decline significantly, households in negative equity may be unable to refinance their mortgage in order to move to a more prosperous region or may be unwilling to sell their home at a loss. For instance, mobility in the United States declined by approximately 15% between 2005 and 2009, and this decline was concentrated amongst home owners with mortgages, and particularly the most leveraged in this group. This partly reflected adverse labour market developments, but also to some extent the sharp rise in the number of households with negative equity. Residential mobility appears to have fallen more in those US states that experienced a larger rise in the share of households in negative equity (Figure 4.6).

Figure 4.6. **The impact of negative equity on residential mobility in the United States**[1]

Percentage point change 2007-09



1. The change in residential mobility rate is measured as the difference between the share of households that moved in the period 2006-07 and the period 2008-09.

*** denotes statistical significance at 1% and ** at 5% confidence level.

Source: Calculations based on US Census Bureau (2008), American Housing Survey (AHS).

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Efficient and equitable policy interventions in housing markets

Whether public policy interventions in housing markets are achieving their desired objectives efficiently and equitably can sometimes be questioned. One policy objective is usually to repair market failures which may otherwise give rise to inefficiencies in housing markets. These market failures might include unequal market power between landlords and tenants or environmental and neighbourhood externalities associated with new housing developments. To address such imperfections, governments impose various regulations (*e.g.* rental and other regulations) on housing markets. Another purpose of government interventions is to promote broader economic performance, for instance by encouraging the release of land for productive uses. Equity and social concerns also motivate interventions in housing markets and the link between housing and broader social outcomes guides socially acceptable standards of housing. These standards can be met by social housing, which is one way for governments to provide housing to disadvantaged households and to redistribute income. Finally, increasing home ownership is often a policy objective in many countries, motivated by the perception that it generates positive neighbourhood effects and raises social capital. However, the evidence for such effects is weak. Besides, some of the mechanisms that were at play in the recent crisis were linked to the owner-occupancy sector and may have been exacerbated by taxes favouring home ownership. This section outlines some of the policies that can be developed to ensure a more equitable and efficient housing sector.

Tax owner-occupied housing in the same way as other investments

In many OECD countries, owner-occupied housing typically has more favourable tax arrangements than other forms of capital investment. This unequal fiscal treatment between housing and other investments should be removed by ensuring that the difference between pre- and post-tax returns is the same for housing as for alternative uses of savings. Housing investments should ideally be taxed as part of income tax in the same way as other assets, by taxing imputed rental income, less depreciation allowances, while allowing for interest rate deductibility (*i.e.* tax net imputed rental income).

In practice, only a few countries tax imputed rents and those that do often substantially under-estimate the rental values. Even though most countries levy recurrent taxes on immovable property, these taxes sometimes apply to both owner-occupiers and tenants and are not a perfect substitute for taxes on imputed rents. In any case, the magnitude of these property taxes appears to be small in most countries, as reflected by their low contribution to fiscal revenues (OECD, 2009). In addition, the valuation of the administrative property value for tax purposes lags well behind the market value in many countries. At the same time, mortgage interest payments can be deducted from the personal income tax base in about half of the countries and a few countries have tax credits for owner-occupancy.[12] In these cases combining mortgage interest deductibility with levying of recurrent property taxes at a higher level, consistent with the taxation of financial income is a second-best solution, though local government control over property taxes makes it difficult in many cases to implement this approach in a co-ordinated way. An alternative second best solution would consist in removing mortgage interest deductibility. In any case, property valuations used for tax purposes need to be regularly updated. These updating schemes could include special arrangements to reduce liquidity constraints for people with low incomes and non-liquid assets.

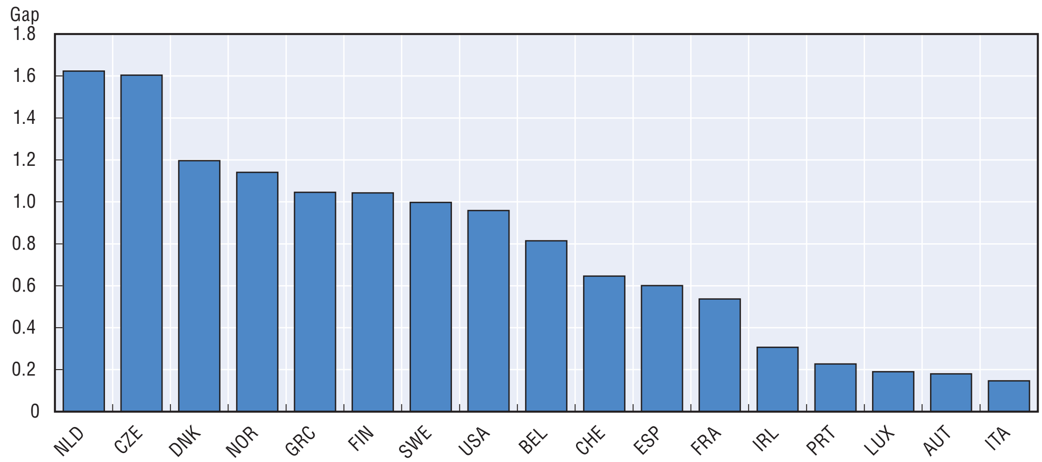
One simplified measure of the favourable tax treatment of owner-occupied housing with respect to debt financing is to look at the difference between the market interest rate and the after-tax debt financing cost of housing (Fukao and Hanazaki, 1986; van den Noord, 2005).[13] The data show generous tax relief on debt financing costs in countries such as the Czech Republic and the Netherlands (Figure 4.7).

Avoid taxes which favour home ownership

Aside from influencing tenure choice, tax favouring of housing can lead to excessive housing investment and crowd out more productive investments, thereby adversely

Figure 4.7. **How different OECD countries apply tax relief on debt financing cost of homeownership,[1] 2009**

Gap between market interest rate and after tax debt financing cost
(the larger the figure, the greater the tax relief)



1. This indicator takes into account if interest payments on mortgage debt are deductible from taxable income and if there are any limits on the allowed period of deduction or the deductible amount, and if tax credits for loans are available. For countries that have no tax relief on debt financing costs, this indicator takes the value of zero.

Source: Johansson, Å. (2011), "Housing Policies in OECD Countries: Survey-based Data and Implications", *OECD Economics Department Working Papers*, forthcoming.

StatLink http://dx.doi.org/10.1787/888932368783

affecting productivity and growth (OECD, 2009). Moreover, taxes which favour home ownership may encourage speculative behaviour by lowering the cost of borrowing to finance housing investment. In turn, this can raise house price volatility with adverse consequences for macroeconomic stability. OECD analysis provides some evidence for this (Table 4.2).

By facilitating high leverage, the combination of tax favouring of housing and deregulation of mortgage markets can also push up house prices (Capozza *et al.,* 1996; Harris, 2010), particularly if housing supply responsiveness is rigid. This combination of policies would not necessarily expand housing opportunities for households. For example, the OECD estimates that if the extent of tax relief on mortgage debt financing was decreased from the level seen in Finland to that prevailing in France (Figure 4.7), the increase in real house prices associated with a given increase in housing demand (*e.g.* following easier access to credit) would be around 50% smaller, all else being equal (Andrews, 2010).

Policies such as mortgage interest deductibility also tend to be inequitable since they subsidise house purchases by higher income households who are more likely to own their home even without a subsidy. This reflects that in most countries, tax relief for debt financing costs is a deduction against earned income and not a credit, and thus is worth more to high-income earners. While housing tax reform is considered to be politically unpopular, highlighting the inequitable nature of mortgage interest deductibility could help to facilitate reform.

Moreover, there appears to be no cross-country evidence to suggest that greater mortgage deductibility coincides with higher overall home ownership rates. Instead, estimates suggest that through their indirect adverse effect on prices, generous housing tax relief on debt financing costs does little to encourage home ownership by lower-income households (Andrews and Caldera Sánchez, 2011). Distributional effects are complex and where there is capitalisation of the effects of tax relief, first-time (often low-income) home buyers are likely to benefit less than existing owners.

Re-design rental regulations

Rental regulations are generally aimed at correcting market imperfections. For instance, one motivation for standardising rental contracts is to prevent landlords from exploiting their market power or tenants from abusing landlords' property (*e.g.* if there are no sanctions for unpaid rent). Most studies generally conclude that on average rent controls generate only small benefits for tenants and that such regulations tend to be poorly targeted (*e.g.* Turner and Malpezzi, 2003; Ellingsen and Englund, 2003). Across the countries covered in this chapter, there is no clear evidence that rent levels are lower in countries with stricter rent controls.[14] Instead, rent regulations may redistribute income among different categories of tenants (Basu and Emerson, 2000). For instance, where rent is controlled landlords tend to inflate rents for new tenants in order to compensate for the loss of rent suffered during occupancy due to the control mechanisms. Thus, rent regulations may discriminate between those households who move often and those who stay and benefit from long rent-controlled tenancies.

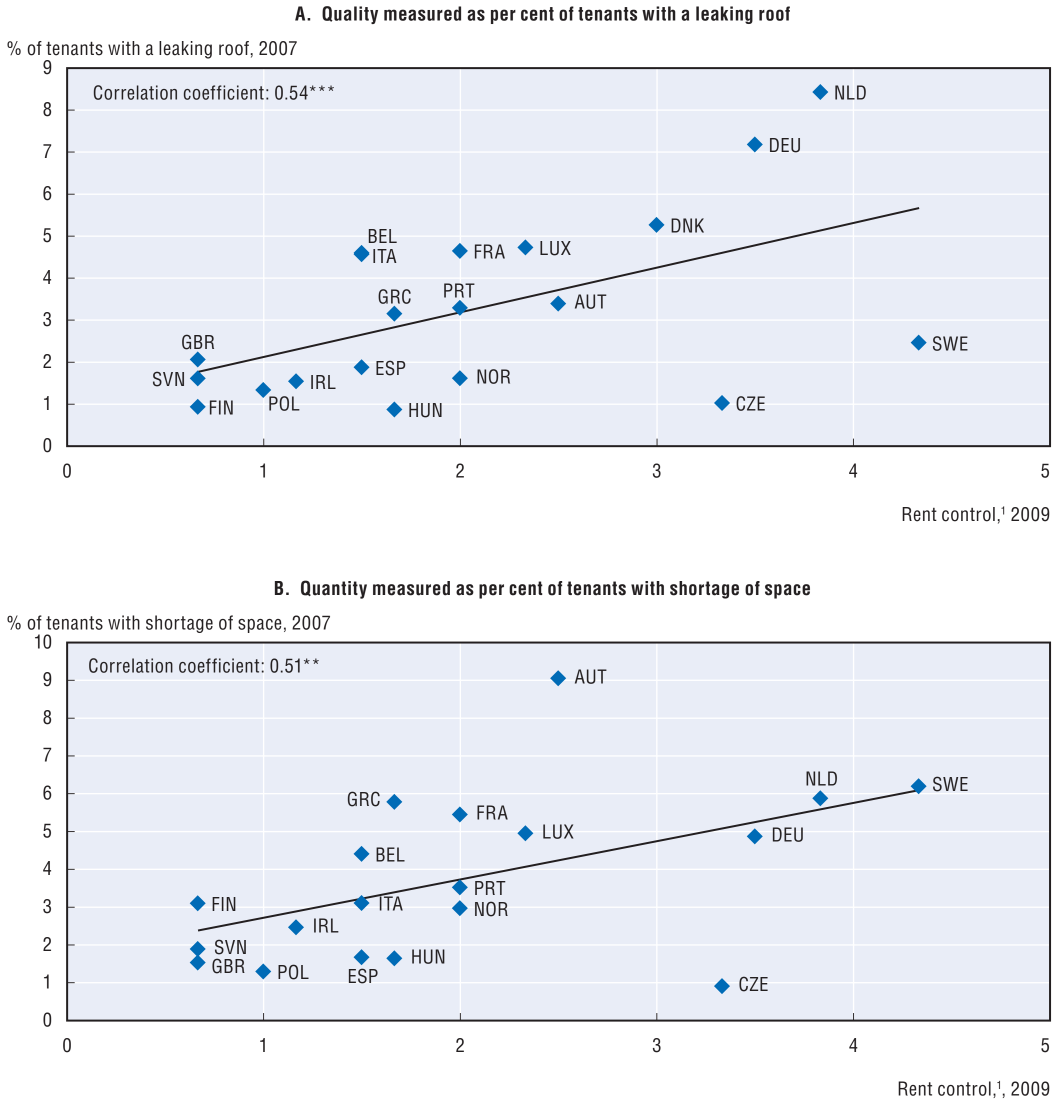
Moreover, as discussed earlier, if stringent rent regulations cap rent levels, they can potentially discourage new construction and maintenance by lowering the net return on these investments (Sims, 2007; Arnott, 2003). An illustrative correlation shows that across countries, stricter rent control tends to be associated with lower quantity and quality of rental housing, as measured by the share of tenants who lack space and who have a leaking roof (Figure 4.8). Below-market rents may also encourage households to spend effort and resources on obtaining cheap housing, which can lead to waste of resources and a misallocation of existing housing (Glaeser and Luttmer, 1997).

Despite its potentially adverse effects, well-designed rent control can be justified where the costs of moving are high and where insurance is not available for protecting tenants from sharp, unanticipated rent increases. However, rental regulations should strike a balance between landlords' and tenants' interests, provide reasonable security of tenure and avoid market segmentation between sitting and new tenants. A compromise could be a system in which rents can be varied for new contracts and for contract renewals, while rent increases are regulated in line with tenancy market developments within the duration of the contract, coupled with an adequate security of tenure.

Design social housing schemes carefully

Social housing is one way for governments to provide low-cost housing to poorer households. In general it consists of rental dwellings, although home ownership can be common in some countries (*e.g.* Italy, Mexico and Spain). The importance of social rentals varies across OECD countries. In some countries it accounts for the majority of rentals (*e.g.* in Austria, the Czech Republic, Ireland, the Netherlands, the Nordic countries, Poland and the United Kingdom), while playing only a minor role in others (*e.g.* Hungary, Luxembourg, Portugal and Switzerland). Across the OECD, there are two types of system for providing social housing (Table 4.4): *i)* In the majority of countries social housing is targeted at certain households (*e.g.* low-income, young, elderly, etc.). In some of these countries, housing is allocated to eligible tenants (based on income thresholds) *via* some

Figure 4.8. **Strict rent control is associated with lower quality and quantity of housing**



1. This indicator includes control of rents, how increases of rents are determined and extent of cost pass-through onto rents.

*** denotes statistical significance at 1% and ** at 5% confidence level.

Source: Johansson, Å. (2011), "Housing Policies in OECD Countries: Survey-based Data and Implications", *OECD Economics Department Working Papers*, forthcoming; European Commission (2007), Eurostat EU-SILC Database.

StatLink http://dx.doi.org/10.1787/888932368802

queuing system, with consideration given to the priority rating of tenants. Others place greater emphasis on the needs of the most vulnerable households. *ii)* In a few countries (*i.e.* Denmark, Luxembourg, the Netherlands and Sweden) social housing is open to all.[15]

The allocation and governance of social housing are complex. In principle, a targeted system is to be preferred as it can focus on households in greatest need of housing and therefore achieve its goals at a lower cost than less targeted social housing systems. However, highly targeted needs-based systems can encourage spatial segregation (Fitzpatrick and Stephens, 2007). Such residential segregation can result in significant disparities in the quality of and access to education, as well as in access to transport

Table 4.4. **In a majority of countries, social housing provision is targeted to special needs**

Based on eligibility and allocation criteria

Size: Percentage of social housing in the total dwelling stock	Broad-based system	Targeted system	
	No income limit waiting list	Income limits, waiting list with some combination of priority groups	Income limits, needs/priority based allocation
0-5%	Luxembourg	Estonia Korea Mexico Norway Slovak Republic Switzerland United States	Australia Italy Portugal Hungary Greece Slovenia
6-10%		Belgium New Zealand Ireland	Canada Germany Israel
11-20%	Sweden	Poland Spain	Czech Republic Finland France United Kingdom
More than 20%	Denmark Netherlands	Austria	

Source: Johansson, Å. (2011), "Housing Policies in OECD Countries: Survey-based Data and Implications", *OECD Economics Department Working Papers*, forthcoming.

networks and public services (*e.g.* Galster, 2007). This can have negative consequences for individual labour market outcomes and potential adverse effects on overall economic performance.[16] Thus, such programmes should be designed to avoid spatial concentration by ensuring that location of social housing is well integrated in the urban structure. It is also important to frequently reassess a household's eligibility for social housing, and to increase the rent or terminate the contract with advance notice if the household's situation has improved. This frees up social housing for needier households. An additional complication is that means-tested social housing systems may potentially reduce job-seeking incentives amongst the unemployed, or discourage low-wage workers from seeking higher paid jobs if social housing is withdrawn or rents are increased as earned income grows. The design and phasing out of social housing benefits should minimise any such adverse effects.

Consider rent allowances for enhancing housing opportunities

The direct provision of social housing is only one way in which governments attempt to enhance housing opportunities for low-income households. Many countries also have some form of means-tested allowances for rental accommodation. The design, take-up and generosity of rental allowances vary widely across countries. They appear to be most significant in Ireland, the United Kingdom and some Nordic countries in terms of the value and coverage of subsidies. Where housing supply is constrained in the short run, however, part of the benefit of government rent allowances may shift from renters to landlords without necessarily enhancing housing availability for needy households. Indeed, there is some evidence that rent allowances are passed onto higher rents (*e.g.* Gibbons and Manning, 2003; Kangasharju, 2003; Susin, 2002). Thus, such allowances may entail fiscal costs without necessarily providing large improvements in housing opportunities for low-income households, particularly if supply is rigid. Moreover, like social housing, rent allowances can undermine work incentives, particularly for second-earners, if benefits are phased out as earned income increases (*e.g.* Immervoll *et al.,* 2008). Even so, well-designed portable housing allowances – for instance, systems where the size of the subsidy is based on a norm rent and only to be used for housing costs – may be preferable to the direct provision of social housing as they do not seem to directly hinder residential mobility.

Notes

1. This chapter is based on analysis in Andrews, D. Caldera-Sánchez, A. and Å. Johansson (2011), "Housing Markets and Structural Policies in OECD Countries" which provides extensive references to the literature on housing markets.
2. Negative equity is when the outstanding loan on a house is greater than the market value of the house.
3. 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.
4. The loan-to-value ratio has risen in many OECD countries, for example from 80% to 100% in Belgium, France and Spain between 1990 and 2000. In some cases commercial banks may grant a mortgage above the maximum loan-to-value ratio if a mortgage insurance is taken out, but often this is costly.
5. The effect for older households is much smaller. The same estimates imply that on average, over all age groups, a 10 percentage point increase in the loan-to-value ratio raises aggregate home ownership by 3%.
6. Housing equity withdrawal is new borrowing secured on homes that is not invested in the housing markets, so it represents additional funds available for reinvestment or to finance consumption spending.
7. Loans with very high loan-to-value ratios also became more common in other OECD countries, such as in the Netherlands and the United Kingdom, although they generally constituted a much smaller share of the loan pool than in the United States.
8. The analysis of the effect of banking supervision takes into account the following factors: *i)* whether a country adopted a capital adequacy ratio based on the Basel standard; *ii)* the extent to which banking supervision agencies are independent of executives' influence; *iii)* if banking supervisory agencies conduct effective supervisions through on-site and off-site examinations; and *iv)* if the banking supervisory agency covers all financial institutions without exception (see Abiad *et al.,* 2008 for more details).
9. The average refers to a simple average of the mobility rates of the countries included in the analysis, *i.e.* the rates are not weighted by the relative size of each country. The mobility rates are annualised.
10. These results should be interpreted with caution because causation cannot be easily established due to the possibility that households' preferences for mobility influence the choice of tenure (so-called self-selection bias). See Caldera Sánchez and Andrews 2011 for details.
11. It is possible that some potential costs, such as litigation in the event of property purchase disputes, are not properly accounted for in this indicator.
12. In most OECD countries realised capital gains from the sale of principal homes are tax-exempt, or their taxation is deferred if reinvested in another principal home. The value of the house is, though, subject to inheritance tax in the majority of countries.
13. This indicator takes into account whether interest payments on mortgages are deductible from taxable income and, if so, any limits on the allowed period of deduction or the deductible amount and whether tax credits for loans are available. Obviously, other features of the tax system (notably recurrent taxes on property and the fiscal treatment of imputed rents) affect the cost of owner-occupancy.

14. Clearly households in rent-controlled dwellings benefit from lower rent, but because of poor targeting, many of these households have incomes which do not justify such controls. Therefore, these controls may achieve little in the way of income redistribution and they have large efficiency costs (O'Sullivan and de Decker, 2007; Ellingsen, 2003).
15. However, even in these countries often local governments reserve a number of dwellings for individuals with special needs (*e.g.* the Netherlands, Sweden).
16. For instance, there is evidence of adverse neighbourhood effects on educational achievement of children through peer group effects (*e.g.* Gibbons, 2002).

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Economic Policy Reforms 2011
Going for Growth

PART II

Chapter 5

Tackling Current Account Imbalances: Is there a Role for Structural Policies?

This chapter presents new OECD empirical analysis which points to some potential for structural reforms to reduce global imbalances by influencing saving and investment rates. For example, social welfare and financial market reforms could curb the current account surpluses of several emerging countries including China. Likewise, growth-enhancing product market reform could reduce the surpluses of some advanced economies such as Japan and Germany by boosting capital spending. The OECD scenario analysis outlined here shows that a package of fiscal consolidation and structural reforms in the main world economies could possibly reduce current global imbalances by about a third.

Summary and conclusions

Global current account imbalances widened markedly in the years prior to the crisis in both OECD countries and non-OECD countries. Though the crisis brought some reversal of this trend in 2009, imbalances remain wide and in some countries may be widening again. If policies do not change, the issue of imbalances worldwide and within the euro area is likely to remain of concern.

Structural reforms – such as of social welfare systems, labour, product and financial market regulation and taxation – are not generally designed to address global imbalances. However, such reforms can affect current accounts by influencing household and firms' saving and investment decisions, as well as altering public saving and investment. For this reason, they have regularly been advocated to help reduce global imbalances in the G20 context. This chapter provides new empirical evidence on the current account impact of structural policies in the areas of social welfare systems, labour, product and financial market regulation and taxation. It explores two questions: *i*) How can structural policy reforms influence saving and investment? Since a country's current account position is equal to the gap between domestic saving and investment, the chapter focuses on the impact of reforms on saving and investment separately, drawing implications for current accounts. *ii*) How can fiscal tightening and structural reforms reduce global imbalances in practice? Scenario analysis quantifies the impact of possible reform packages on the size of imbalances worldwide, and within the euro area. While current account constellations result from a global general equilibrium, the chapter mainly focuses on the impact of domestic reforms on domestic saving and investment, assuming unchanged foreign policies.[1]

The following main findings emerge from the first part of the analysis:

- Structural reforms that boost productivity boost both saving and investment and on balance weaken the current account position.
- Reforms that raise public revenues or reduce expenditures strengthen a country's total saving rate and its current account balance, all else being equal.
- Higher social spending (in particular on health care) is likely to lower the saving rate and thereby weaken the current account, since there is less need for households to put aside funds as a protection against unforeseen emergencies such as sickness or disability. This is true even if the higher social spending is fully financed by higher taxes or lower spending elsewhere.
- Financial market liberalisation seems to reduce saving, increase investment and thereby weaken the current account.
- The removal of anti-competitive product market regulation (PMR) appears to boost investment and weaken the current account in the short term.
- Relaxing employment protection legislation (EPL) seems to strengthen the current account through two channels: *i*) by raising saving in countries where unemployment

benefits are low as households save more for precautionary motives; and *ii*) by reducing investment, at least in OECD countries, reflecting weaker substitution of capital for labour.

- A lower tax burden on firms boosts business investment and thereby weakens the current account.

Based on these findings, a number of structural reforms that are desirable on efficiency, welfare or equity grounds could reduce global imbalances (*i.e.* weaken the current account position of countries with surpluses or improve the current account position of countries with deficits) by narrowing the gaps between domestic saving and investment in several major economic areas:

- Developing social welfare systems in China and other Asian economies would fulfil an important social goal, and as a side-effect would reduce the need for precautionary saving, thus curbing the large current account surpluses of some of these countries.
- Financial market reforms that increase the sophistication and depth of financial markets could relax borrowing constraints in emerging economies and thus help to reduce the high saving rates and current account surpluses observed in some of them.
- Pension reforms that increase the age of retirement would make public budgets sustainable and at the same time help to reduce current account surpluses (but raise deficits in external deficit countries). Pension reforms that cut replacement rates would have the opposite effect on the current account position.
- Product market reforms in network industries, retail trade or professional services could encourage capital spending and thereby reduce current account surpluses in countries such as Japan and Germany.
- The eventual removal of policy distortions that encourage consumption, such as tax deductibility of interest payments on mortgages in the absence of taxation of imputed rent (see Chapter 4), might help increase household saving and reduce external deficits in a number of countries, not least the United States, though implementation would have to await greater stabilisation of the economy.

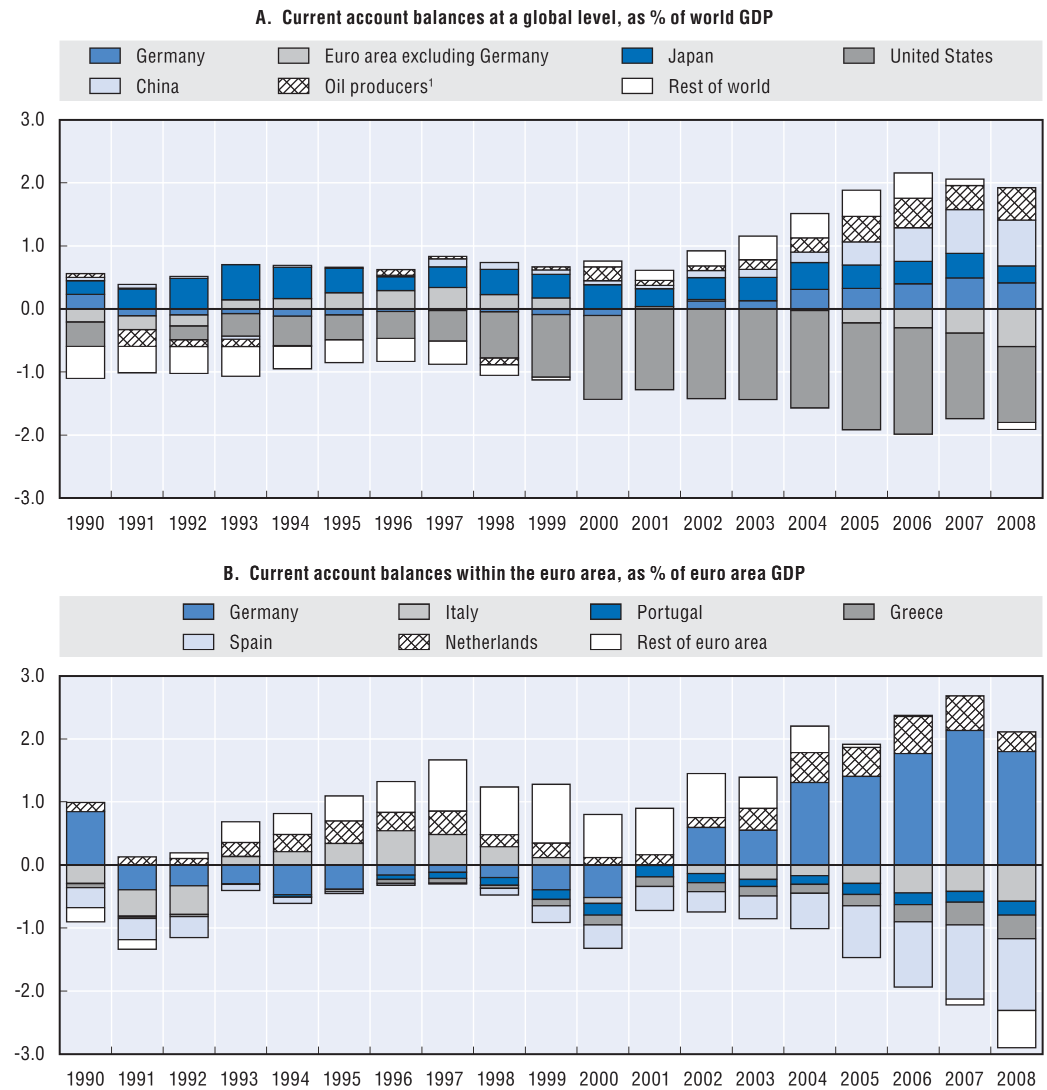
In the second part of the chapter, the scenario analysis indicates that:

- Fiscal tightening to stabilise debt-to-GDP ratios in OECD countries by 2025 could reduce the size of global imbalances by almost one-sixth.
- Global imbalances could decline by twice as much if China, Germany and Japan were to deregulate their product markets and China were to raise public health spending by 2 percentage points of GDP (in a fiscally-neutral way) and liberalise its financial markets.
- The fiscal tightening would narrow imbalances moderately within the euro area.
- Lowering employment protection in Spain, Portugal and Greece would only slightly reduce the *overall* size of intra-euro-area imbalances, but the current account deficits of these three countries might fall considerably.

Introduction: recent trends in current account imbalances

Global current account imbalances widened markedly in the years preceding the global economic crisis. The United States had the biggest deficit, while several of the fast-growing Asian and oil-producing countries, as well as Germany and Japan, had the largest surpluses (Figure 5.1, Panel A). While the euro area's current account balance with the rest

Figure 5.1. **Widening current account imbalances worldwide and in the euro area, 1990-2008**



1. Angola, Azerbaijan, Bahrain, Brunei Darussalam, Congo, Ecuador, Kazakhstan, Gabon, Iran, Kuwait, Libya, Oman, Saudi Arabia, Sudan, Tobago, Trinidad, Venezuela and Yemen.

Source: World Bank (2010), *World Development Indicators (WDI) Database.*

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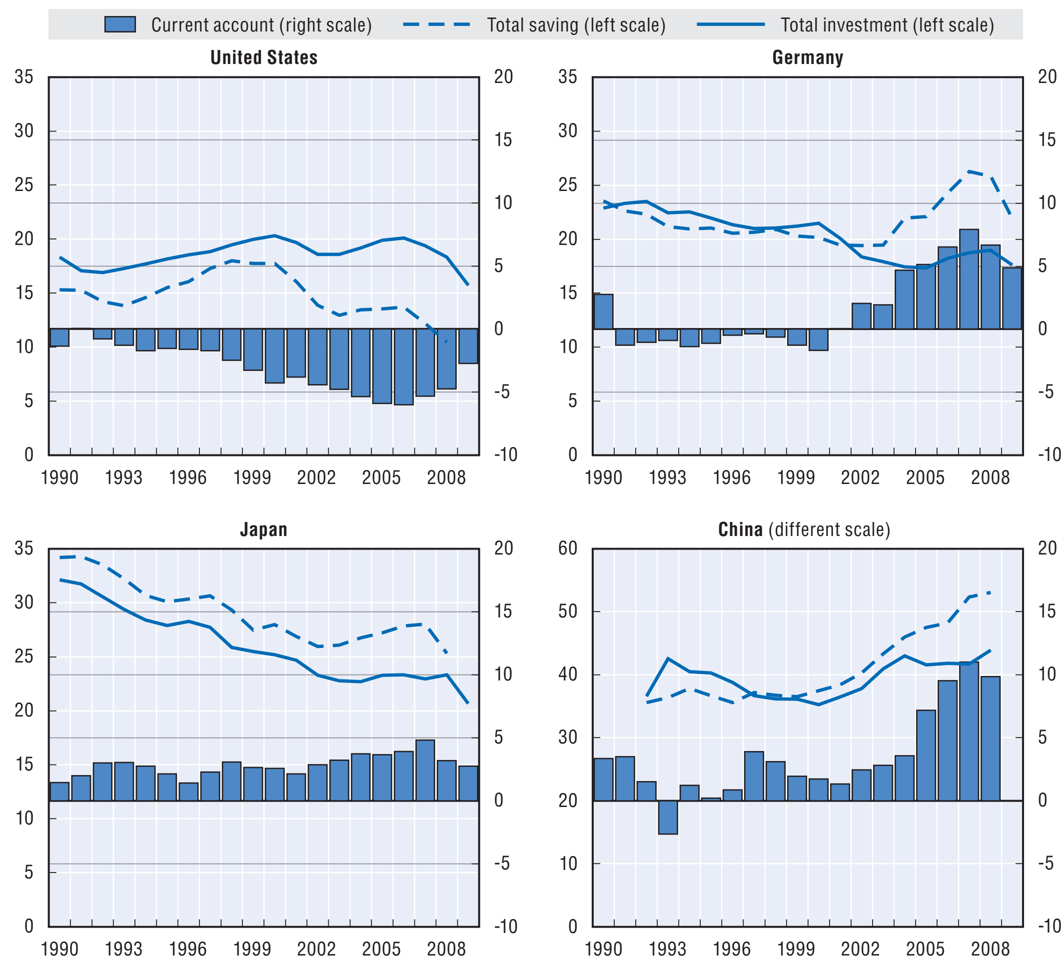
of the world was relatively small, a number of individual member countries recorded either sizeable and growing deficits (in particular Greece, Portugal and Spain) or surpluses (next to Germany mainly the Netherlands; Figure 5.1, Panel B). The current account balance of a country is equal to the gap between its national saving and investment rates. Although a few countries have experienced sizeable changes in investment rates, rising saving rates in surplus countries and falling saving rates in deficit countries were the dominant drivers of their divergent current account positions (Figure 5.2).

The economic crisis led to a substantial narrowing of global current account imbalances as well as to a change in their composition. While tighter credit conditions, rising labour market uncertainty and efforts to make up for the sudden wealth losses caused household saving rates in developed countries to rise from their pre-crisis levels,

Figure 5.2. **The increase in current account imbalances is mirrored by widening saving-investment gaps – China, Japan, Germany and the United States, 1990-2010**

Per cent of GDP



Source: World Bank (2010), *World Development Indicators* (WDI) and OECD (2010), *National Accounts Statistics Databases*.

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this was generally more than offset by lower government saving. At the same time, total investment rates fell substantially in most countries, driven by declines in business investment and, at least in those countries that had experienced house price and construction booms in the run-up to the crisis, falling residential investment. The narrowing of global current account imbalances is unlikely to be permanent, however, and indeed as the recovery unfolds imbalances are widening again (OECD, 2010a).

How do structural policy reforms influence saving and investment?

Developing social welfare systems could reduce the need for precautionary saving

Households hold a certain amount of precautionary wealth as a cushion against unexpected adverse events such as unemployment, sickness or disability. This amount of precautionary wealth, and with it the level of precautionary saving, depends on the risk aversion of the household, the probability of adverse events and their expected severity. While policy is unlikely to affect households' aversion to risk, it may well affect the other two factors. For example, a rise in public spending on health may reduce the likelihood of diseases through higher-quality preventive medicine and may reduce the private cost of sickness through better public insurance. New OECD research yields evidence that a higher share of GDP spent on public health provision is associated with lower household saving rates (Box 5.1 and Table 5.1). This lends weight to the notion that improving the coverage

Box 5.1. **Empirical strategy for estimating the effects of structural reforms on current account balances**

Current accounts result from the general equilibrium of the world economy, and as such they are driven by multiple factors, including domestic and foreign structural policy settings. For this reason, one way to explore the current account effects of structural reforms is through simulations of a general equilibrium model (see, for example, Fournier and Koske, 2010, for a simulation of the current account effects of productivity-enhancing structural reforms). However, given theoretical complexities and ambiguities, this remains ultimately an empirical issue. New OECD research has investigated the impact of structural reforms on current accounts by relating the GDP shares of saving, investment and the current account balance to policy indicators and other influential, so-called control variables. The policy indicators span five different policy areas: social welfare systems, regulation in labour, product and financial markets, and taxation. The set of control variables includes the user cost of capital, productivity growth, the change in the working age population, terms-of-trade changes, the real long-term interest rate, the old and youth dependency ratios and government net lending. In the current account equations, all explanatory variables are expressed relative to a GDP-weighted cross-country average to take into account that current accounts are influenced both by domestic and foreign economic conditions.

The analysis has been carried out for two data sets, the first one covering 30 OECD countries between 1965 and 2008 and the second covering a total of 117 OECD and non-OECD economies between 1993 and 2008. The large time span of the first data set has allowed for the estimation of both the immediate and the longer-run reactions of saving, investment and current accounts to changes in policy settings. While the second dataset is more limited in its time span and the range of policies covered, it has allowed a broader set of countries to be studied, and has also facilitated the analysis of policies that change little over time or for which indicators are not available over long periods.

However, the empirical approach has a number of shortcomings which have to be kept in mind when interpreting the results: *i*) It does not explicitly account for the joint determination of current accounts and other macroeconomic outcomes. In particular, the (real) exchange rate is not included in the set of explanatory variables as both it and the current account are simultaneously driven by the determinants of saving and investment. The equations include other variables that may also be jointly determined with the current account (*e.g.* interest rates), which may bias the estimated effects. *ii*) The approach does not allow for distinguishing between different types of reforms (*e.g.* temporary *versus* permanent reforms, expected *versus* unexpected reforms, credible *versus* non-credible reforms). The analysis is thus likely to capture an average effect across different reform experiences. *iii*) The approach treats saving and investment decisions separately. This assumption of independence between saving and investment is unlikely to be true in reality as capital markets are imperfectly integrated. *iv*) Structural policies are likely to influence saving and investment decisions through changes in the macroeconomic control variables, reducing the chances of finding significant direct effects of the policy variables themselves.

Source: Kerdrain, C., I. Koske and I. Wanner (2010), "The Impact of Structural Policies on Saving, Investment and Current Accounts", *OECD Economics Department Working Papers,* No. 815.

Table 5.1. **Overview of the estimated effects of structural policies on saving, investment and current account positions**

Long-run impact,[1] % of GDP

	Total saving rate	Total investment rate	Current account balance[4]
Increase in public health spending by 1% of GDP	–1.9	–	–1.9
Financial market reform (similar to average change across OECD over past decade)[2, 3]	–1.3	0.6	–1.9
Increase in the statutory retirement age by 1 year	–0.5	–	–0.5
Product market liberalisation (similar to average change across OECD over past decade)[2]	–	–0.4	0.4
Lowering of employment protection (similar to average change across OECD over past decade)[2]	–	–0.1	0.1

Note: The effects refer to reforms that do not lead to changes in the government's budget balance.

1. As the investment impact of product market reforms vanishes after a few years, the table shows the change in the investment rate in the year following the reform.
2. Average change between 1998 and 2008 (or the latest available year).
3. Measured by the change in the GDP share of credit to the private sector. The numbers shown in the table reflect the results for this particular measure of financial market reform and do not hold for all other measures employed in the analysis (see Kerdrain *et al.*, 2010 for details).
4. Sum of the saving and investment rate effects.

Source: Based on Kerdrain, C., I. Koske and I. Wanner (2010), "The Impact of Structural Policies on Saving, Investment and Current Accounts", *OECD Economics Department Working Papers,* No. 815.

and quality of public health care systems will reduce the need for households to put aside savings as a precaution. Though the size of the effect is hard to pin down precisely, this research suggests that for the "typical" OECD country, a 1 percentage point increase in the GDP share of public health spending (that is financed and thus does not affect the government's budget balance) may reduce the total saving rate and therefore the current account balance by almost 2 percentage points of GDP, all else being equal.[2, 3] The effect appears to be stronger under low initial levels of social spending (Figure 5.3).[4] For example, in China, this increase in public health spending would reduce the current account surplus by as much as 2.5 percentage points of GDP.[5]

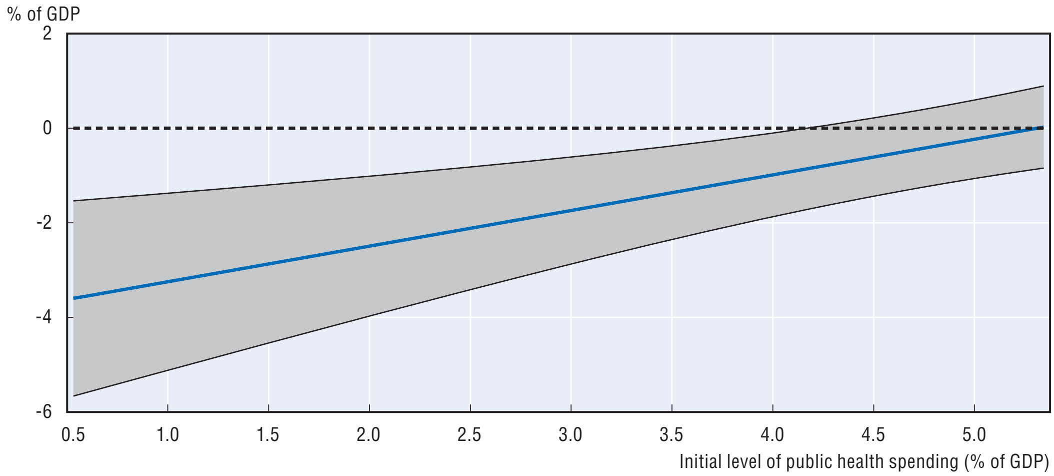
In the same vein, the precautionary saving behaviour of households may be influenced by the level and duration of unemployment benefits – higher or longer-lasting benefits could reduce households' need to save for "rainy days". Empirical evidence at the household level supports this view for individual countries,[6] although new OECD research did not find a robust link for a broad set of OECD countries (Kerdrain *et al.*, 2010). Other relevant design features of social welfare systems include the asset tests associated with means-tested social programmes, which may discourage households from saving in order to qualify for benefits.[7]

Pension reforms can also affect individual households' saving rates. Reforms that improve the sustainability of pension systems by cutting pension benefits should increase the saving rates of the working-age population as households attempt to accumulate more wealth in order to cushion themselves from reduced income in retirement. Existing empirical analysis backs this up, showing that benefit cuts raise private saving, especially for workers aged between 35 and 45.[8]

In contrast, unexpected increases in the statutory retirement age should induce individual workers to save less as they have more years to accumulate wealth and fewer years during which to spend it. However, the effect on the total saving rate may be partially offset by a higher number of workers or by older workers saving more to self-finance their original retirement plans.[9] New OECD analysis (Kerdrain *et al.*, 2010) confirms other

Figure 5.3. **The response of the total saving rate to higher public health spending is stronger under low initial levels of spending**

Saving rate response to a 1% of GDP rise in public health spending



Note: The shaded area indicates the 90% statistical confidence interval around the estimated effect. The figure shows the total saving rate response to a rise in public health spending by 1% of GDP for different levels of spending. For example, for a country that spends initially 3% of GDP on public health, an increase in expenditure by 1% of GDP could reduce the total saving rate by about 2% of GDP.

Source: Based on Kerdrain, C., Koske, I. and I. Wanner (2010), "The Impact of Structural Policies on Saving, Investment and Current Accounts", *OECD Economics Department Working Papers,* No. 815.

StatLink http://dx.doi.org/10.1787/888932372526

research (Kirsanova and Sefton, 2007) which finds that increasing the statutory retirement age lowers total and private saving rates. The estimates suggest that a rise in the statutory retirement age by one year reduces total and private saving rates by around half a percentage point of GDP. This effect should, however, gradually fade away as existing generations get older and new ones have fuller knowledge of the new features of the system.[10]

Implementing labour market reforms

Labour market policies should affect individuals' saving, as well as investment behaviour. While labour market institutions such as the level of the minimum wage and the bargaining power of unions may *a priori* influence the saving behaviour of households, there is not much empirical evidence in favour of such links. EPL may influence the amount of money households wish to save as a protection against the risk of unemployment. On the one hand, weaker EPL may raise precautionary saving by increasing the likelihood of dismissal.[11] On the other hand, weaker EPL may reduce saving by increasing job turnover and thereby lowering the expected length of unemployment spells. Recent OECD research based on a broad sample of OECD and non-OECD countries finds some evidence that less stringent EPL pushes up aggregate saving rates, but only in countries with very low or no unemployment benefits (Kerdrain *et al.*, 2010). In this case the higher likelihood of dismissal is apparently the dominant factor influencing households' saving decisions. For OECD countries, by contrast, there is no evidence that the saving rate is influenced by EPL, possibly because the comparatively higher level of unemployment benefits in these countries provides an alternative way to insure income against the risk of job loss.

By influencing labour costs, labour market policies may also affect the investment behaviour of firms. For example, a higher minimum wage or stronger union bargaining power may raise unit labour costs. While this may divert some investment to other countries with lower unit labour costs, it may also induce firms to substitute capital for labour.[12] The impact on the investment rate would therefore be ambiguous.[13] The same effects should be caused by more stringent employment protection which increases hiring and firing costs. New OECD analysis cannot find much evidence that the investment rate is influenced by minimum wages or union bargaining power – possibly because the effects are small or the available indicators and the empirical approach are insufficient to identify such effects (Kerdrain *et al.*, 2010). However, it does suggest that less stringent EPL (in particular for temporary workers) might lower investment and improve the current account in OECD countries. But the effect is at best small: a typical EPL reform would reduce private and total investment only by around 0.1 percentage points of GDP.

Liberalising product markets could boost investment, at least temporarily

Product market reforms can influence the investment behaviour of firms in several conflicting ways.[14] By reducing the mark-up of prices over marginal costs and lowering entry barriers, output and hence capital accumulation generally increase. At the same time, product market liberalisation may boost investment indirectly through higher productivity growth. However, where information is not equally shared, internal and external sources of financing may not always be perfectly substitutable. In this way, reductions in mark-ups may actually depress investment because profits that may have served as an internal source of funding are reduced. Product market reforms might also initially depress investment if accompanied by the privatisation of public enterprises that had been overinvesting.[15]

Existing studies generally point to a positive link between product market reforms and investment, especially the removal of entry barriers. Privatisation also tends to be associated with higher investment, suggesting that the positive effect from lower entry costs outweighs the reduction in overinvestment. In line with these findings, new OECD research suggests that product market liberalisation can temporarily boost both private and total investment, though this effect is rather small (Kerdrain *et al.*, 2010). For example, aligning the level of economy-wide PMR in Japan and Germany with OECD best practice could increase total investment – and hence reduce their current accounts, all else being equal – by 0.15 and 0.25 percentage points of GDP respectively.

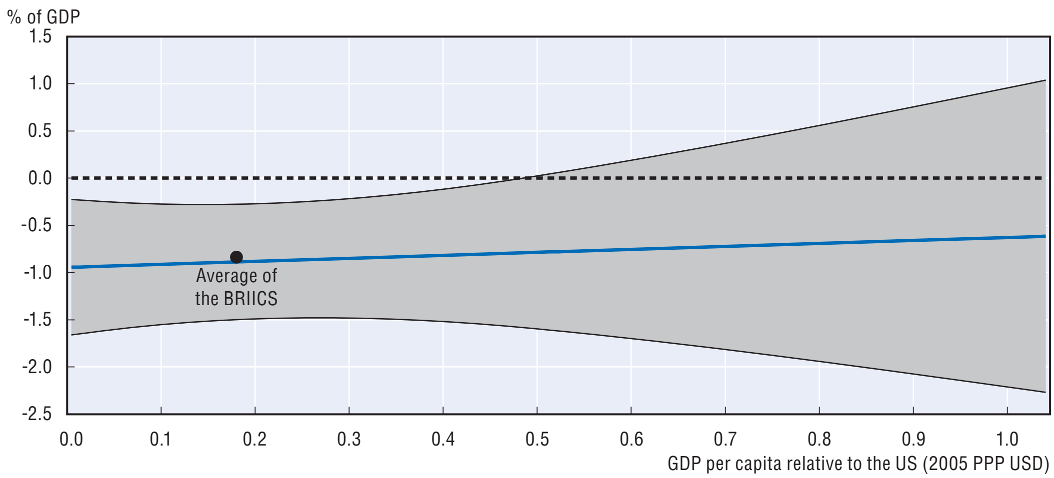
Reforming financial markets could reduce saving and raise investment

Financial market reform has an ambiguous effect on the saving behaviour of firms and households. Reforms that increase the depth or sophistication of domestic financial markets, for example by relaxing borrowing constraints while providing adequate prudential regulation, might reduce saving. Financial market development which better matches the supply of financial services to individual preferences, risk aversion and income profiles might also widen saving opportunities. In addition, financial market development might influence saving by altering rates of return and lending margins (*e.g.* by lowering transaction costs) or by influencing the rate of productivity growth.

Research into the link between financial market regulation and saving shows a mixed picture. Some studies suggest that deeper or more sophisticated financial markets lower saving rates (Loayza *et al.,* 2000; Bandiera *et al.,* 2000). Others are unable to establish a significant relationship (Cheung *et al.*, 2010). One possible explanation for this mixed evidence is the existence of "threshold effects". These mean that the negative effect on saving of removing borrowing constraints may dominate in the early stages of financial development, while the positive impact from more diverse financial services and expected returns may become more important at later stages. New OECD analysis supports this explanation (Kerdrain *et al.*, 2010). It finds that financial market reforms only reduce saving in countries with GDP per capita levels below half of the US level (Figure 5.4). So, for example, if China liberalised its financial system as much as it did between 1995 and 2005, its total saving rate and thus the current account surplus could drop by over 3 percentage points of GDP.

Figure 5.4. **The saving rate response to financial market reform is larger in less developed countries**

Saving rate response to a "typical" financial market reform



Note: BRIICS = Brazil, Russia, India, Indonesia, China and South Africa. PPP = Purchasing power parity. The shaded area indicates the 90% statistical confidence interval around the estimated effect. Financial market reform is measured by the change in the financial reform index (Abiad *et al.*, 2010). This ranges from 0 to 21, with 0 being the least and 21 being the most liberal financial system. The figure shows the total saving rate response to a change in the financial reform index by 1.86, which corresponds to the average change in the index in OECD countries between 1995 and 2005.

Source: Based on Kerdrain, C., Koske, I. and I. Wanner (2010), "The Impact of Structural Policies on Saving, Investment and Current Accounts", *OECD Economics Department Working Papers* No. 815; Abiad, A., E. Detragiache and T. Tressel (2010), "A New Database of Financial Reforms", *IMF Working Paper*, No. 08/266, International Monetary Fund.

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Financial market reform should stimulate investment, not least by lowering the cost of acquiring and evaluating information on prospective projects and by reducing the risk of resource mismanagement through easier monitoring of investments. Financial market imperfections in emerging and developing countries might be one reason why these countries have partly invested in advanced countries such as the US (Caballero, 2006; Caballero *et al.*, 2008). However, where financial repression is associated with households supplying cheap capital to enterprises, liberalisation may raise the cost of capital and thus lower investment. Financial market reforms may also reduce the interdependence between saving and investment decisions, for example by relaxing borrowing constraints or by reducing information asymmetries that drive a wedge between internal and external costs of finance. Overall, several recent empirical studies support the view that deeper or more sophisticated financial markets are associated with higher investment and weaker current accounts (OECD, 2003; Chinn and Ito, 2007; Dorrucci *et al.,* 2009; Cheung *et al*., 2010). New OECD analysis also points in this direction (Kerdrain *et al*., 2010), but the results are somewhat less robust than those of previous studies.

Overall, taking into account both the potential investment and saving effects of financial reforms mentioned above, there appears to be significant room for financial liberalisation to reduce the current account surpluses of a number of emerging countries, not least China.[16]

Reforming tax systems could affect saving and investment rates

Tax reforms may affect the current account through a variety of different channels. To the extent that the reforms alter the after-tax rate of return on saving, they should affect the level of saving with the direction of the impact depending on the relative strength of the substitution, income and wealth effects.[17] In practice, a number of individual country studies have concluded that a reduction in the after-tax rate of return (*e.g.* by cutting down tax deduction of interest expenses) boosts the saving rate and thus strengthens the current account.[18, 19] Measures such as corporate tax cuts or larger capital depreciation allowances may weaken the current account position by raising investment (Vartia, 2008; Schwellnus and Arnold, 2008; Hassett and Hubbard, 2002).[20]

Tax subsidies may not have much effect on saving levels and current accounts, although they can affect the allocation of household saving by unduly distorting incentives to save. For example, provisions that exempt labour income from income taxes if the income is saved for retirement do not in general boost private saving. While some studies of this subject find positive effects (Poterba *et al.,* 1996; Rossi, 2009), others point to sizeable crowding-out, at least for some types of households (Attanasio *et al.,* 2004; Corneo *et al.,* 2009), meaning that households do not increase their level of saving but only re-allocate saving from unsubsidised to subsidised forms. As for saving accounts not related to pensions, previous OECD research found that they only encourage saving when moderate-income households participate in them (OECD, 2007).

How far can fiscal tightening and structural reforms contribute to reduce global imbalances?

Setup of the scenario analysis

The previous section has outlined the effects of policy changes on current account positions. In this section these are brought together to estimate the effects of possible growth-enhancing policy reform packages on current account imbalances worldwide and within the euro area.[21, 22] Given the likelihood of and need for major fiscal tightening across the OECD over the coming years, two types of scenarios have been assessed (see Table 5.2 for assumptions): *i*) Only fiscal measures (ignoring structural reforms), with all OECD countries assumed to adjust their underlying primary balance (*i.e.* government net borrowing or net lending excluding interest payments on consolidated government liabilities) so as to stabilise the debt-to-GDP ratio by 2025. *ii*) Both fiscal measures and structural reforms, the latter aimed at reducing current account imbalances in countries with sizeable deficits or surpluses.

Both scenarios are applied at two levels: global (OECD countries plus China); and within the euro area (OECD countries that are members of the euro area). At the global level, China,

Table 5.2. **The scenario analysis considers both fiscal measures and structural reforms**

	Fiscal measures (Scenario 1)	Fiscal measures and structural reforms (Scenario 2)
Global level	• All OECD countries adjust their underlying primary balance so as to stabilise the debt-to-GDP ratio by 2025	• All OECD countries adjust their underlying primary balance so as to stabilise the debt-to-GDP ratio by 2025 • Germany and Japan align their level of product market regulation with OECD best practice, and China implements product market reforms similar in size to those that happened in OECD countries between 1998 and 2008 • China increases public social spending on health by 2% of GDP • China implements financial market reforms that are similar in magnitude to those undertaken between 1995 and 2005
Euro area level	• All euro area countries adjust their underlying primary balance so as to stabilise the debt-to-GDP ratio by 2025	• All euro area countries adjust their underlying primary balance so as to stabilise the debt-to-GDP ratio by 2025 • Germany aligns its level of product market regulation with OECD best practice • Greece, Portugal and Spain align their level of EPL with OECD best practice

Germany and Japan are assumed to liberalise their product markets and China is assumed to implement financial market reforms and to increase public spending on health. In the euro area, in addition to the liberalisation of German product markets it is assumed that Greece, Portugal and Spain reform their labour markets (Table 5.2). While these reforms are very specific in nature, the results of the simulation exercise should be interpreted as referring to more systematic links between labour market reforms and current account positions.

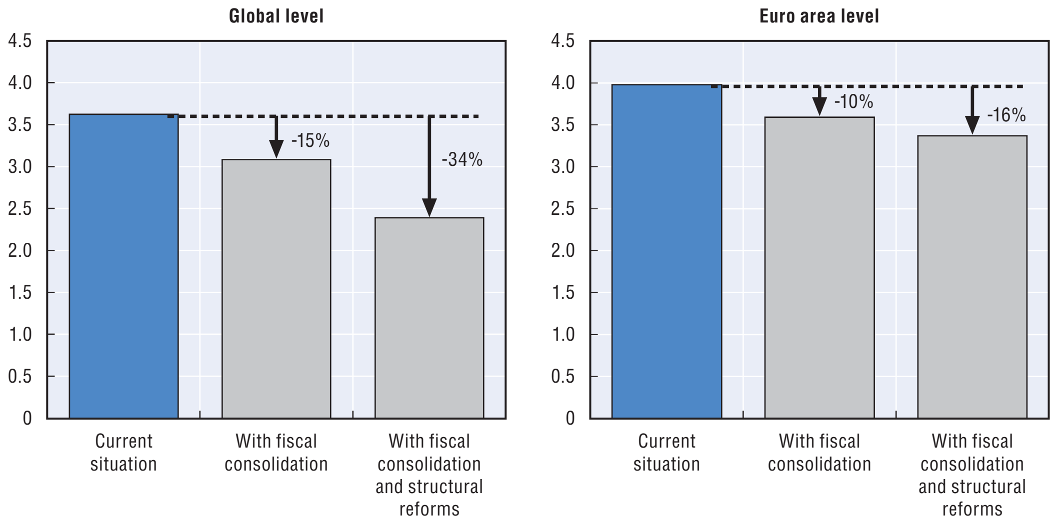
Results

Figure 5.5 shows the simulated impact of structural reforms and fiscal consolidation on the size of global and intra-euro-area imbalances. Global imbalances are measured as the GDP-weighted sum of the absolute saving-investment-gap-to-GDP ratios of all countries considered. Overall, as the need for fiscal tightening is generally stronger in external deficit countries than in surplus countries, global imbalances would narrow by about one-sixth as a result of fiscal consolidation, while the effect on intra-euro-area imbalances would be somewhat smaller. In the United States, fiscal consolidation would raise the aggregate saving rate and thereby reduce the current account deficit. However, due to private saving offsets and simultaneous fiscal tightening in other countries, the deficit would decline by less than the improvement in the government's budget balance, *i.e.* by just 1 percentage point of GDP instead of 7.3 percentage points of GDP over the next 15 years. In Japan, fiscal tightening would raise the current account surplus by about half a percentage point of GDP over the same period. In Germany, the current account surplus would fall, reflecting the smaller effort needed to stabilise the debt-to-GDP ratio compared with other countries. As for other euro area countries, substantial fiscal tightening would reduce current account deficits, especially in Greece, Portugal and Spain.

If countries were to implement structural reforms in addition to the fiscal measures, global imbalances would be reduced by about one-third over the next 15 years, compared with one-sixth in the purely fiscal scenario (Figure 5.5).[23] Removing competition-unfriendly PMR in China, Germany and Japan would temporarily reduce the current account surpluses in all three countries by boosting investment. An increase in public health expenditure in China (by 2 percentage points of GDP) would reduce the country's current account surplus by about 4 percentage points of GDP.[24] The decline in the surplus attributable to structural reforms could reach over 7½ percentage points of GDP if China were also to implement financial market reforms. Similarly, implementing these structural

Figure 5.5. **Structural reforms and fiscal consolidation can help to reduce external imbalances**

External imbalances as % of region-wide GDP



Note: The size of imbalances is measured as the sum of the absolute saving-investment-gap-to-GDP ratios of all countries in the region, weighted by 2009 GDP (in current USD). The current extent of imbalances (current situation) is calculated based on the current-account-to-GDP ratios in 2009. The impact of fiscal consolidation and structural reforms shown here would materialise after 15 years.

Source: Based on Kerdrain, C., Koske, I. and I. Wanner (2010), "The Impact of Structural Policies on Saving, Investment and Current Accounts", *OECD Economics Department Working Papers,* No. 815.

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reforms in the euro area would help to narrow imbalances in the euro area countries. While the overall size of this effect would be rather modest, current account imbalances would be reduced significantly in the smaller euro area countries, where they are currently sizable.

Notes

1. The chapter builds on Kerdrain *et al.* (2010) and Fournier and Koske (2010).
2. While this effect is likely to be rather persistent, the associated run-down in wealth will eventually reverse this fall in the saving rate.
3. If an improvement in the health of the working-age population raises employment and thus investment, the current account position may weaken by even more than the fall in the saving rate.
4. This is consistent with existing evidence, see *e.g.* Furceri and Mourougane (2009) and Baldacci *et al.* (2010).
5. For a detailed analysis of the Chinese health care system and reform potentials see OECD (2010b).
6. For example, Engen and Gruber (2001) show for the United States that cutting the unemployment benefit replacement rate by half would increase gross financial asset holdings by 14% for the average worker.
7. See for example Hubbard *et al.* (1995), Gruber and Yellowitz (1999) and Nam (2008) for evidence from the United States. However, Hurst and Ziliak (2006) and Sullivan (2006) could not find any evidence of this effect.
8. See Attanasio and Brugiavini (2003) and Feng *et al.* (2009). Attanasio and Brugiavini (2003) looked at a simultaneous rise in the retirement age and a cut in the level of benefits and found that it was associated with a rise in the saving rate. This could either be explained by the dominant impact of the benefit cut, or by the immediate impact of an increase in the retirement age, which could

encourage individuals to increase their saving in order to finance them retiring earlier than the new official retirement age.

9. There is tentative evidence from research on the relative impact of unfunded *versus* funded pension schemes, that pay-as-you-go systems lower saving rates (Samwick, 2000).
10. Although individuals may leave some of their wealth to their heirs, the size of the bequest should not rise indefinitely over generations.
11. Several existing studies show that individuals who have a higher probability of losing their job consume less or save more (*e.g.* Benito *et al.*, 2006; Carroll *et al.*, 2003).
12. Detrimental effects of strict EPL on foreign direct investment inflows are confirmed by several recent studies (*e.g.* Nicoletti *et al.*, 2003; Javoric and Spatareanu, 2005).
13. There is even some evidence that strict employment protection in a firm's home country makes the firm reluctant to relocate abroad, at least temporarily (Dewit *et al.*, 2009).
14. See Alesina *et al.* (2005) for a thorough discussion of the links between PMR and investment.
15. In the case of network sectors such as telecommunication, however, privatisation may put an end to underinvestment.
16. This negative effect of financial development on current accounts appears to be greater in the presence of a strong legal system that increases the returns on investment through increased transparency and predictability of economic activity (Chinn and Ito, 2007).
17. For example, a rise in the interest rate makes saving more attractive than consumption (substitution effect). However, it increases the return on existing saving and thereby reduces the amount of saving that is necessary to achieve a certain level of interest income (income effect). Finally, higher interest rates reduce the value of existing wealth, pushing up the saving rate if households are net lenders, but having the opposite effect if they are net borrowers (wealth effect).
18. See Summers (1984) for the United States and Koskela and Virén (1994) for Denmark, Finland and Sweden.
19. The saving rate may also be influenced by the progressivity of the income tax system, with a more progressive tax system expected to lower the aggregate saving rate since higher-income households tend to have a higher propensity to save. However, recent OECD analysis could not find robust evidence for such effects (Kerdrain *et al.*, 2010).
20. Tax reforms may also affect the allocation of savings by applying different tax treatments to different types of capital income. An example would be to allow tax deductibility of interest expenses on mortgages where there is no taxation of imputed rent from housing (see Chapter 4).
21. The results of this rather simplistic simulation exercise need to be interpreted with care since the precise magnitudes of the current account effects of policy reforms are surrounded by a high degree of uncertainty. Moreover, the simulations treat saving and investment separately and abstract from possibly heterogeneous interest rate responses (in particular to fiscal tightening).
22. To account for the fact that relative (rather than absolute) movements in macroeconomic conditions and structural reforms drive current accounts reforms in a given country are measured relative to weighted average of the reforms that take place in all countries considered.
23. Due to time lags in the adjustment of saving and investment behaviour, the decline in current account imbalances will continue beyond the 15-year horizon. After 25 years, global (intra-euro-area) imbalances will have been reduced by 17% (12%) for fiscal consolidation only and by 34% (17%) for fiscal consolidation and structural reforms.
24. The 2% of GDP increase in public health spending is spread equally over the first two years of the simulation period, with the saving rate effect of the first-year increase (2.5% of GDP) larger than that of the second-year increase (1.8% of GDP) to take into account the finding that the saving rate effect of increases in public health spending declines with the level of spending.

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PART II

Chapter 6

A New Look at OECD Health Care Systems: Typology, Efficiency and Policies

Rising health care spending is putting pressure on government budgets. Governments will have to make their health care systems more efficient if they are to maintain quality of care without putting further stress on public finances. The OECD has assembled new comparative data on health policies and health care system efficiency for its member countries. These show that all countries surveyed can improve the effectiveness of their health care spending. If all countries were to become as efficient as the best performers, life expectancy at birth could be raised by more than two years on average across the OECD, without increasing health care spending. There is no single type of health care system that performs systematically better in delivering cost-effective health care, as both market-based and more centralised command-and-control systems have strengths and weaknesses. It seems to be less the type of system that matters, but rather how it is managed. Policy makers should aim for policy coherence by adopting best practices from other health care systems and tailoring them to their own circumstances. Nevertheless, the international comparison highlights a number of sources of potential efficiency gains, such as from improving to co-ordination of the bodies involved in health care management, strengthening gate-keeping, increasing out-of-pocket payments, enhancing information on quality and prices, reforming provider payment schemes or adjusting regulations concerning hospital workforce and equipment. By improving the efficiency of the health care system, public spending savings would be large, approaching 2% of GDP on average across the OECD.

Summary and conclusions

Being in good health is a key dimension of well-being. Healthier people also tend to enjoy better access to the education system and to be more productive for longer, thus supporting economic growth. Raising health status, however, has come at the cost of a brisk increase in public health care spending in virtually all OECD countries. The corresponding increase in taxes and/or the reduced spending on other items may have adverse impacts on economic growth. This chapter looks at how countries can improve the health of their citizens in an efficient manner. The first part of the chapter reviews recent developments in health care outcomes and spending and how these may affect economic growth and well-being. It presents estimates of the potential efficiency gains countries could achieve by reforming their health care sector and the public spending savings that could be achieved by doing so. The key results are as follows:

- Life expectancy at birth could be raised by more than two years on average across the OECD, without increasing health care spending, if all countries were to become as efficient as the best performers. By way of comparison, a 10% increase in health care spending would increase life expectancy by only three to four months.
- Potential efficiency gains are the highest – extending life by over four years on average – in Denmark, Hungary, the Slovak Republic and the United States.
- For more than one-third of countries, better efficiency could improve life expectancy as much in the 10 years to 2017 as in the previous 10 years, while keeping health care spending constant.
- Improving efficiency would result in large public spending savings in most OECD countries, amounting to 1.9% of GDP on average by 2017. Savings would be over 3% of GDP for Greece, Ireland and the United Kingdom.

The second part of the chapter outlines a new health care system typology to investigate the links between policy settings and health care system efficiency. This analysis, which allocates 29 OECD countries into six groups, suggests that no "health care system" is clearly superior in delivering gains in health status. Thus, a "big bang" approach – switching from one type of system to another – may not necessarily improve efficiency much. However, this international comparison highlights areas of potential reforms and efficiency gains:

- Improve *co-ordination* of the bodies involved in health care management. This is especially needed at the interface between providers (hospitals and out-patient care), for the transition into long-term care, and where key health care decisions are fragmented across levels of government. This should be an area for investigation in Austria, Australia, Canada, Denmark, Italy, Mexico, Poland, Sweden, Switzerland and the United Kingdom.
- Introduce or strengthen *gate-keeping* to steer demand for specialised services and ensure the appropriate use of different forms of care. Providing incentives for patients to register with a primary care doctor and/or to obtain referral from a primary care doctor

to access specialised care could help reducing the large number of consultations (*e.g.* in the Czech Republic, Japan and Korea) or containing spending on the in-patient sector (*e.g.* Belgium and Iceland).

- Increase *out-of-pocket payments* where they are low and combined with wide patient choice among providers since this combination might induce excessive demand for care. Such a combination is found notably in the Czech Republic and Luxembourg.
- Provide more *information on quality and prices* to enhance competition and to allow the benchmarking of providers, which would help spread best practices. This applies to many countries.
- Consider *reforming provider payment schemes*, both in the in-patient and out-patient sector. More balanced provider payment schemes, for instance between performance-based pay and set wages, would lead to a better match between demand and supply in health care in many countries.
- Adjust *regulations concerning the hospital workforce and equipment*. These should be relaxed in countries where recently reformed hospital payment systems are now mainly based on activity, but where tight regulations of hospital employment and equipment reduce flexibility to respond to the new incentives (*e.g.* Belgium, France and Ireland). In contrast, regulation of the hospital workforce and equipment may need to be strengthened in some countries with little use of market mechanisms for service providers, and an above-average supply of hospital facilities (*e.g.* Finland and Iceland).
- Improve *priority setting* in those countries where there is no precise definition of the health benefit basket, no effective health technology assessment and no clear definition and monitoring of public health objectives. Within the six groups, the most efficient countries tend to be those with the most rigorous priority setting.
- Develop policies to *tackle health inequalities* and improve the understanding of the reasons behind inequalities. For example, Mexico and Turkey should move further towards achieving universal coverage. More investigation is needed into whether inequalities in health status are created by extensive reliance on private insurance (Canada and France), and/or high out-of-pocket payments (Finland, Hungary, Poland and Slovak Republic).

Trends in health care outcomes and spending

Health care outcomes have improved steadily

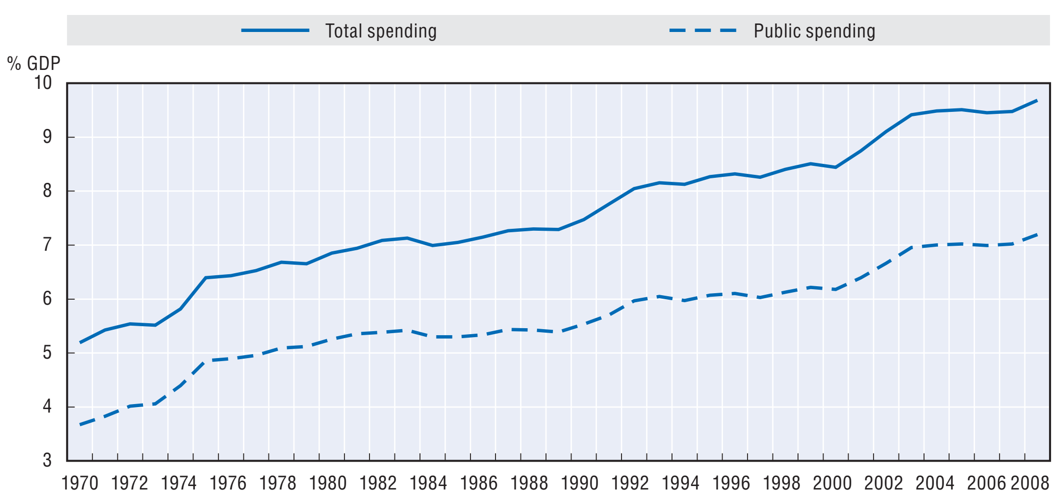
Mortality and longevity indicators all point in the same direction: health in the OECD has improved rapidly in recent decades. In 2008, life expectancy at birth reached 79 years on average in the OECD, a gain of more than 10 years since 1960. Over the same period, infant mortality was reduced by a factor of eight and life expectancy at age 65 increased by more than one-third. Mortality and longevity indicators are imperfect proxies, however, for the impact of the health care system since they also reflect socio-economic factors and lifestyle choices (such as smoking and diet) and do not account for the prevalence of diseases or disability. More sophisticated, but partial, indicators to assess health care outcomes are becoming available (OECD, 2009), though data limitations are still severe for international comparisons. Nevertheless, using them does not change the general picture. As an illustration, the number of people dying within 30 days of an acute myocardial infarction – a leading cause of death in most OECD countries – fell by a quarter between 2003 and 2007 on average for the 12 OECD countries for which data are available. Also revealing is the increase in survival rates after cancer.

Large cross-country differences in health status persist, although they have narrowed. As an illustration, life expectancy at birth ranged from 73.6 years in Turkey in 2008 to 82.7 years in Japan, while there was a 25 year difference between the two extremes in 1960. But infant mortality in Hungary, Mexico, Poland, the Slovak Republic, Turkey and the United States is still more than double that in Finland, Japan and Sweden. Those countries which rank high on health status measures also tend to be characterised by a high quality of care, as measured by low rates of avoidable hospital admissions for specific diseases (*e.g.* asthma) and cancer mortality, although it should be recognised that individual countries can perform well for some diseases and less so for others.

Health spending is increasing briskly

Health care spending per capita rose by 74% in real terms between 1990 and 2008 on average in the OECD. Health care spending absorbed almost 10% of GDP in 2008, up from just over 5% in 1970 (Figure 6.1). While virtually all OECD countries experienced a rapid increase in health care spending, cross-country disparities in spending per capita are very wide (Figure 6.2). Most of the increase in health care spending has been financed by the public sector and spending on health care is now one of the largest government spending items – on average in the OECD in 2008 it absorbed 15% of general government spending, up from 12% in 1995. Furthermore, population ageing, rapidly rising health care prices and costly developments in medical technology are putting upward pressures on health care budgets. According to OECD projections, public health care spending could increase by 3.5 to 6 percentage points of GDP by 2050 on average across OECD countries (Oliveira Martins and de la Maisonneuve, 2007).[1]

Figure 6.1. **Health care spending has increased faster than GDP between 1970 and 2008**[1]



1. Data for a group of 21 OECD countries for which comparable historical series are available.

Source: *OECD Health Data 2010*, June.

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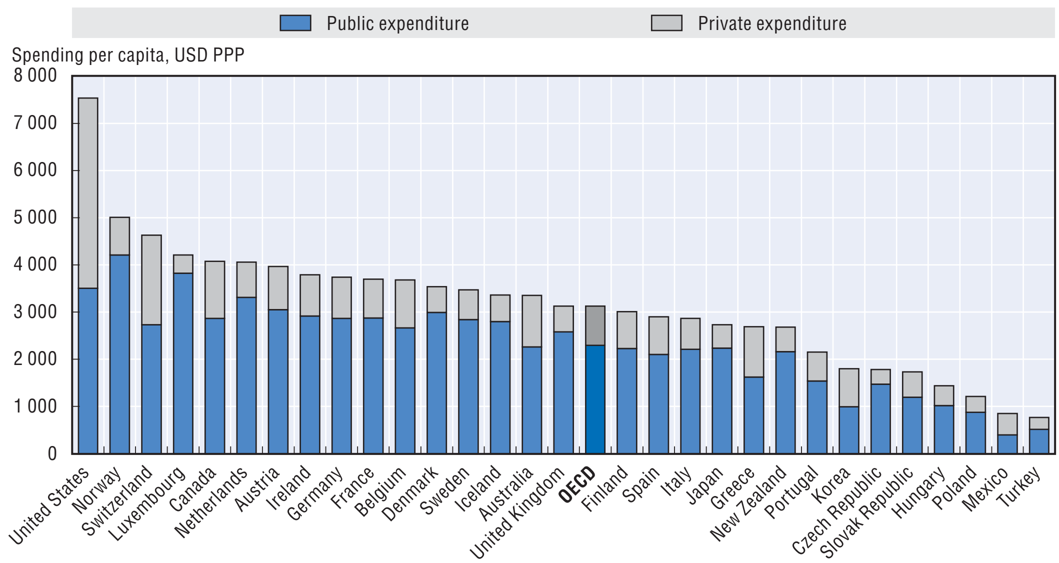
The steady increase in health care spending has underpinned the improvement in health status, thus raising well-being (Box 6.1). Recent OECD empirical work suggests that one-third to a half of the gains in health status can be attributed to the increase in health care spending (Joumard *et al.*, 2008), leading to an average gain in life expectancy of about

Figure 6.2. **Cross-country disparities in health care spending are wide**

2008 or latest available year



Source: *OECD Health Data 2010*, June.

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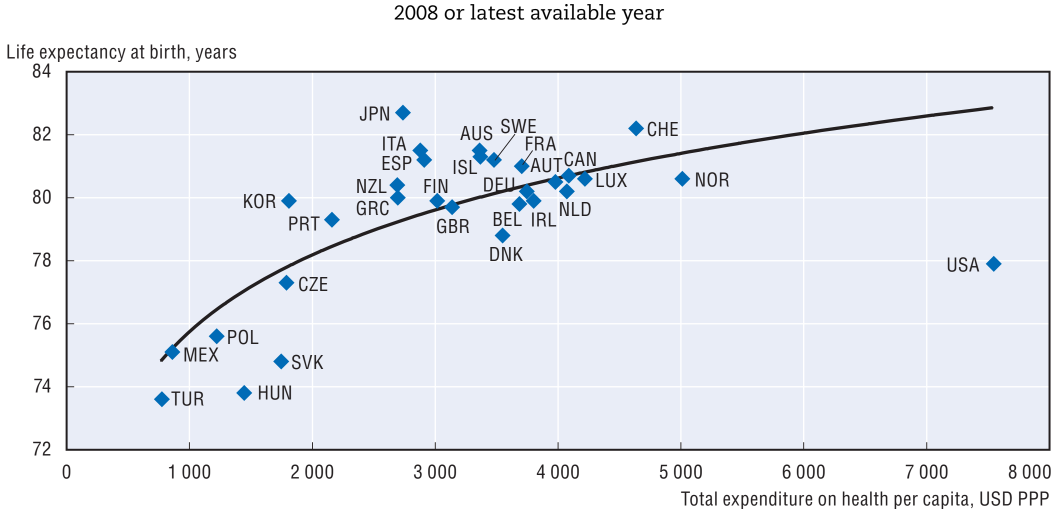
1¾ years between 1990 and 2008. Differences in per capita spending are also the most important factor explaining differences in health status across countries. Nevertheless, the countries that spend the most are not necessarily the ones that fare best in terms of health outcomes, suggesting that there is room to improve the cost effectiveness of spending. As an illustration, Denmark spends slightly more than Sweden and Iceland on health care, but various health outcome indicators are below those of these two other Nordic countries, as illustrated by Denmark's lower life expectancy at birth (Figure 6.3).

Figure 6.3. **Countries which spend the most on health care do not always have the healthiest people**

2008 or latest available year



Source: *OECD Health Data 2010*, June.

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Box 6.1. **The links between health, well-being and economic growth**

The relationship between health and well-being is well established, while the impact on economic growth is less clear-cut. The Stiglitz-Sen-Fitoussi Commission on the Measurement of Economic Performance and Social Progress identified health as a key dimension that should be taken into account when defining well-being (Stiglitz *et al.*, 2010). Good health may contribute more to well-being than to GDP simply because health care services tend to be poorly measured in the national accounts. Indeed, traditionally, the output of government-provided non-market services is measured on the basis of the inputs to produce these services, neglecting any productivity or quality changes in providing these services (Schreyer, 2010). Health may also affect well-being more than income because well-being encompasses dimensions such as social connections and relationships, which may deteriorate when people suffer from chronic or severe health problems. In a study covering 178 countries, White (2007) found that subjective well-being is highly correlated with health (as measured by life expectancy) across countries, ahead of factors such as wealth and access to basic education. Likewise, Layard (2003) argues that happiness is well correlated with many measures of physical health. In a study covering 16 European countries, Blanchflower and Oswald (2007) found that happier nations – as measured by the Eurobarometer life satisfaction scores – report lower levels of hypertension.

Many empirical studies on the impact of better health on economic outcomes have been carried out in recent years (*e.g.* Sala-i-Martin *et al.*, 2004; Aghion *et al.*, 2010; and WHO, 2001). Several channels have been identified that link better health with economic growth (Price *et al.*, 2008; Suhrcke *et al.*, 2005):

i) Labour supply may increase with the health status of the population as the likelihood of early retirement diminishes, the number of sick leaves declines, and the burden on traditional (family) caregivers is reduced, allowing them to take up a job. Greater longevity also raises lifetime consumption and, depending on the pension system, incentives to work.

ii) Better health status may enhance human capital. For instance, unhealthy children may miss school more often. Healthier people, with longer life expectancy, also have stronger incentives to invest in education as the costs can be spread and the associated benefits harvested over a longer period.

iii) Productivity may increase because healthier workers are better at using technology and equipment and adapting to organisational changes.

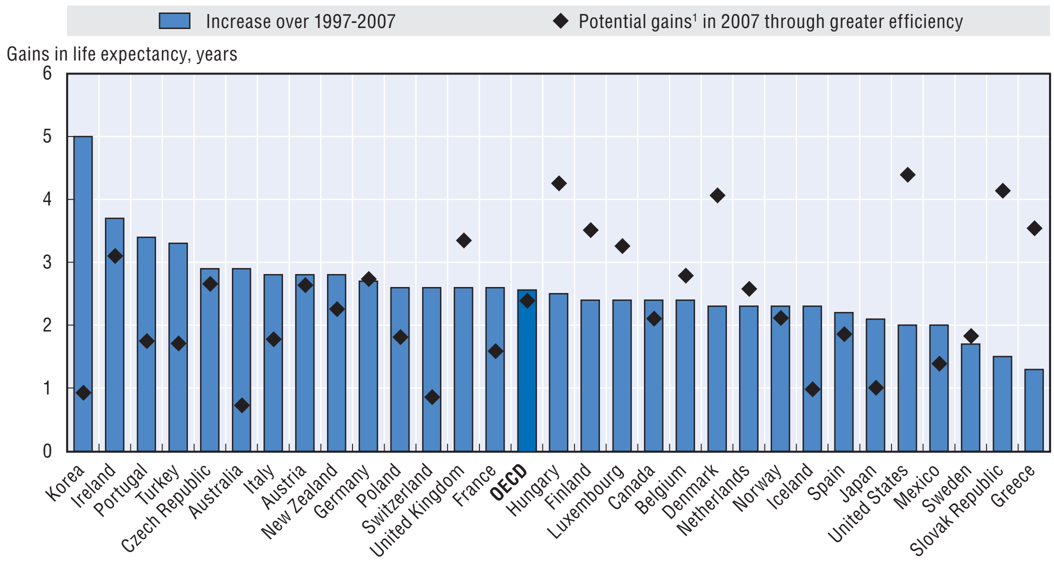
Reviewing the work of others and focusing mainly on developing countries, the World Health Organization Commission on Macroeconomics and Health (WHO, 2001) found that a 10% increase in life expectancy at birth is associated with a rise in GDP growth of at least 0.3 to 0.4 percentage points per year, holding other factors constant. The empirical evidence for developed economies is, however, much weaker than for developing countries (Acemoglu and Johnson, 2007; Bhargava *et al.*, 2001; Hartwig, 2010). One possible explanation is that the increase in life expectancy in OECD countries has mainly benefitted the older, often retired population – almost half of the gain in life expectancy at birth in the OECD area since 1960 reflects the increase in life expectancy at 65. The impact of longevity on productivity, labour supply and economic growth is thus largely muted, while the cost for the public finances may be large, potentially dragging economic growth down.

Efficiency gains could be large and reaping them would support fiscal consolidation

The OECD has compared the efficiency of health care spending across member countries using the health indicator of life expectancy as a gauge. Life expectancy is only a partial indicator since it does not reflect aspects such as disability or the improvement in quality of life due to health care. However, it is highly correlated with more sophisticated indicators of health status but for which data are often missing. Another problem with using life expectancy as a gauge of health care outcomes is that it also reflects lifestyle choices, such as tobacco and alcohol consumption, as well as socio-economic variables, in particular education. These factors therefore have to be controlled for when assessing the efficiency of health care spending. On this basis and testing various methods and assumptions, indicators of health care spending efficiency have been derived. They measure the extent to which health care outcomes could be raised while holding spending constant and appear to be robust to changes in estimation methods and model specifications.[2] Overall, they suggest that:

- Life expectancy at birth could be raised by more than two years on average across the OECD – holding health care spending steady – if all countries were to become as efficient as the best performers. By way of comparison, a 10% increase in health care spending would increase life expectancy by only three to four months.
- The potential for efficiency gains varies widely across countries. Australia, Iceland, Japan, Korea and Switzerland perform best in transforming spending into health outcomes. Here the potential gains through greater efficiency are the smallest – less than one extra year of life expectancy (Figure 6.4). Potential efficiency gains are the highest – over four extra years of life – in Denmark, Hungary, the Slovak Republic and the United States.
- For more than one-third of countries, improving efficiency could increase life expectancy as much in the 10 years to 2017 as in the previous 10 years (1997-2007), while keeping health care spending constant (Figure 6.5). For the other countries, however, the growth in life expectancy could not be maintained without increasing spending.
- Improving efficiency would result in large public spending savings in most OECD countries. This has been calculated by comparing a no-reform scenario with a reform scenario. The no-reform scenario assumes that between 2007 and 2017 life expectancy and spending increase at the same pace as over the previous 10-year period and that the mix between public and private spending remains constant over time. The reform scenario assumes that countries exploit potential efficiency gains. This comparison suggests that potential public savings would amount to 1.9% of GDP on average in the OECD in 2017 (Figure 6.6). Savings would be over 3% for Greece, Ireland and the United Kingdom.
- There is no trade-off between achieving more equal health outcomes within countries and raising the average health status of the population. Indeed, the countries with the lowest health inequalities also tend to enjoy a high average health status – Iceland, Italy and Sweden are good examples.[3] In those countries where the dispersion was the highest in 2006 (the United States followed by Hungary and Poland), the average health status of the population as measured by various indicators stood below the OECD median country.

Figure 6.4. **Greater efficiency could lead to large gains in life expectancy**



1. Potential gains are derived from an output-oriented data envelopment analysis (DEA) performed with one output (life expectancy at birth) and two inputs (health care spending and a composite indicator of the socio-economic environment and lifestyle factors). They are measured by the number of years of life that could be saved if efficiency in country i were to be raised to the level implied by the estimated efficiency frontier while holding inputs constant and under the assumption of non-increasing returns to scale.

Source: *OECD Health Data 2009*, November; OECD calculations.

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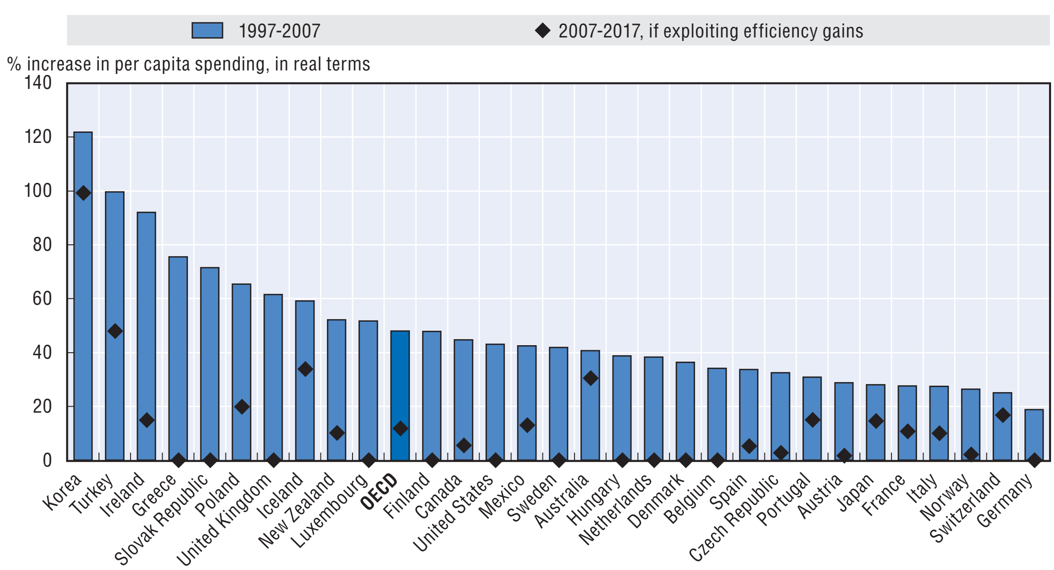
Figure 6.5. **Spending could be restrained without affecting gains in life expectancy**

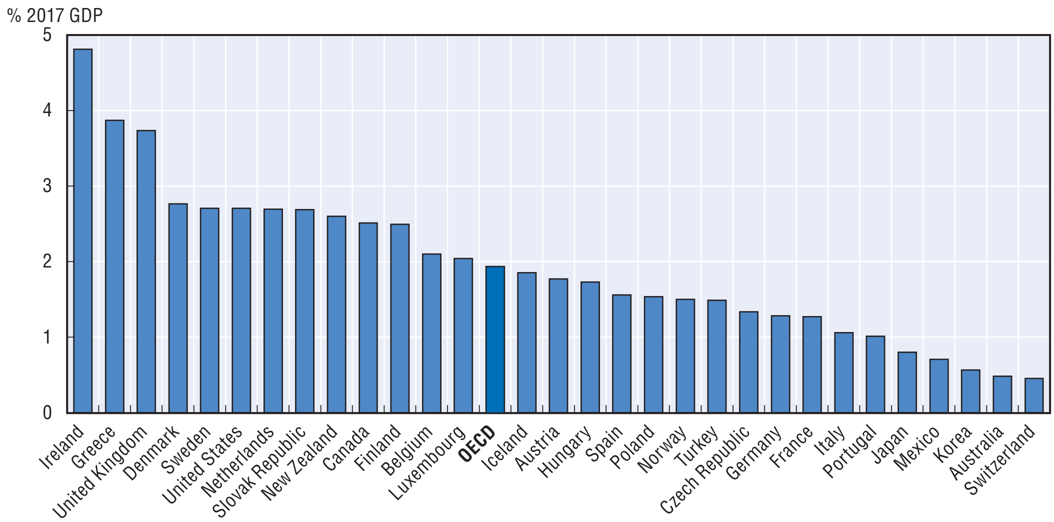


Note: Life expectancy between 2007 and 2017 could increase at the same pace as over the previous 10 years, but at a much lower cost in most countries if estimated potential efficiency gains were to be exploited.

Source: *OECD Health Data 2009*, November; OECD calculations.

StatLink http://dx.doi.org/10.1787/888932372678

Figure 6.6. **Large potential savings exist in public health care spending**



Note: Potential savings represent the difference between a no-reform scenario and a scenario where countries would exploit efficiency gains. The no-reform scenario assumes that between 2007 and 2017 life expectancy and spending increase at the same pace as over the previous 10 years and that the mix between public and private spending remains constant over time.

Source: OECD Health Data 2009, November; OECD calculations.

StatLink http://dx.doi.org/10.1787/888932372697

A new typology of health care systems

To reap the potential efficiency gains, countries need to design reform strategies that cover all the policies and institutional features that matter for efficiency. These can be identified by comparing experiences across countries. However, consistent cross-country information on health policies and institutions had been missing until recently. To fill this void, the OECD used a questionnaire to collect detailed information on incentives and regulations affecting the behaviour of health care providers (hospitals and health practitioners), users and insurers, as well as other dimensions such as the degree of decentralisation in health care policies and the nature of the budget constraint. Twenty-nine OECD countries responded to the questionnaire, launched in 2008.[4]

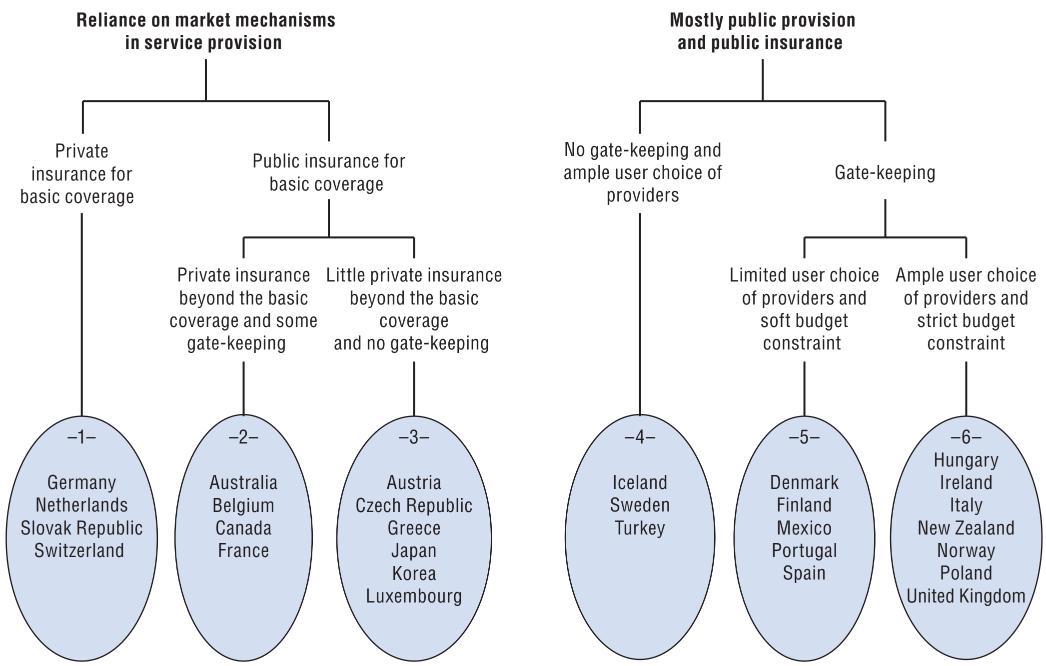
The resulting new OECD dataset shows how health policies and institutions differ across countries. It also allows groups of countries with similar policy settings to be identified. A new typology of health care systems has been developed on the basis of the new OECD dataset. This typology goes beyond the traditional ones, which are most often based on financing criteria, such as the public/private funding mix, or the insurance model (Bismark, Beveridge or private insurance system). The most salient features emerging from the analysis of the new dataset are as follows:

- The basic insurance coverage – measured by population covered, services included and the degree of cost-sharing – is fairly similar across countries. Mexico, Turkey and the United States stand out as exceptions, with still a large share of the population not covered in 2009. In these three countries, however, policies aim at providing greater coverage.
- Some OECD countries rely heavily on centralised command-and-control systems to steer the demand and supply of health care services. In sharp contrast, market mechanisms – involving features such as private provision based on fee-for-services, competition among private providers driven by user choice and private insurance – play a dominant

role in other countries. But more and more countries rely on a mix of the two extreme models. As an illustration, several countries which rely heavily on public providers and public coverage have recently given users greater choice of providers, stimulating competitive pressures among them (*e.g.* Sweden and the United Kingdom).

- Six groups of countries sharing broadly similar institutions – or health care systems – can be identified (Figure 6.7). The degree of reliance on market mechanisms and regulations to steer the demand and supply of health care services – in particular the importance of private providers, how much choice among providers is offered to users, the existence and depth of the health insurance market as well as the stringency of gate-keeping arrangements – is key to characterise health care systems.

Figure 6.7. **Groups of countries sharing broadly similar institutions**



Note: These country groups are derived from a cluster analysis. The countries on the left, such as Germany and the Netherlands, tend to rely on market mechanisms to supply health care whereas those on the right, such as Finland and the United Kingdom, depend more on public command-and-control. Apparently diverse countries fit the same group: the rules in Iceland, Sweden and Turkey for instance all provide for ample user choice even if in practice there are geographical and other constraints. Note that the United States did not participate in the Survey.

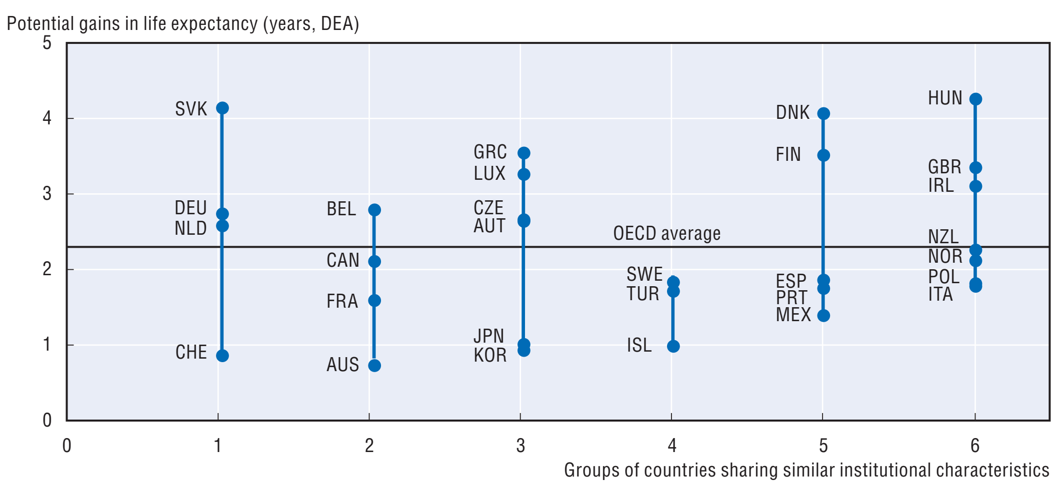
There is no superior health care system

The cross-country efficiency scores show that no single type of health care system systematically outperforms the others. On the contrary, countries performing well can be found in all the groups. Countries doing poorly are also present in most groups. This is illustrated in Figure 6.8, which shows efficiency levels expressed as the extra years of life expectancy which could be obtained while keeping spending constant. The analysis can be summarised as follows:[5]

- Group 1. In the four countries relying extensively on market mechanisms in providing insurance coverage, efficiency is close to the OECD average but there are large differences between countries. Switzerland is one of the most efficient countries; the performance of Germany and the Netherlands is close to the OECD average while the Slovak Republic is performing poorly. In interpreting these results it should, however, be borne in mind that not only are the efficiency estimates subject to some uncertainty but recent health care system reforms in Germany, the Netherlands and the Slovak Republic might not have had their full impact on efficiency yet.

- Group 2. This group is characterised by public basic insurance coverage, heavy reliance on market mechanisms at the provider level and gate-keeping arrangements. For this group, average efficiency is slightly above the OECD average, but again cross-country variation is wide.
- Group 3. This group is also characterised by an extensive use of market mechanisms at the provider level but no gate-keeping and little reliance on private insurance. It is split into two in terms of efficiency. The two Asian countries – Japan and Korea – are performing very well, whereas the results of the others are close to or below average.
- Group 4. Users are given ample choice of providers but private supply is very limited and prices are tightly regulated. Efficiency is high in all countries in this group consisting of Iceland, Sweden and Turkey.
- Group 5. This group includes the countries with heavily regulated public systems and with no choice of providers for the users and strict gate-keeping. Performance is heterogeneous, with Mexico, Portugal and Spain performing fairly well, while the efficiency of the Danish and Finnish systems is low.
- Group 6. Consisting of countries with heavily regulated public systems and a stringent budget constraint, performance within this group varies considerably. Italy, Norway, Poland and New Zealand have relatively efficient systems. Ireland and the United Kingdom are less efficient. Finally, Hungary has been performing poorly.

Figure 6.8. **Efficiency scores across and within country groups**



Note: Potential gains in life expectancy are derived from an output oriented DEA with per capita health care spending and a composite indicator of socio-economic environment and lifestyle factors as inputs for 2007. To facilitate the interpretation, the efficiency scores have been converted into potential gains in life expectancy, i.e. the gains that a country could achieve for a given level of spending if it were as efficient as the best performing country.

Source: OECD calculations.

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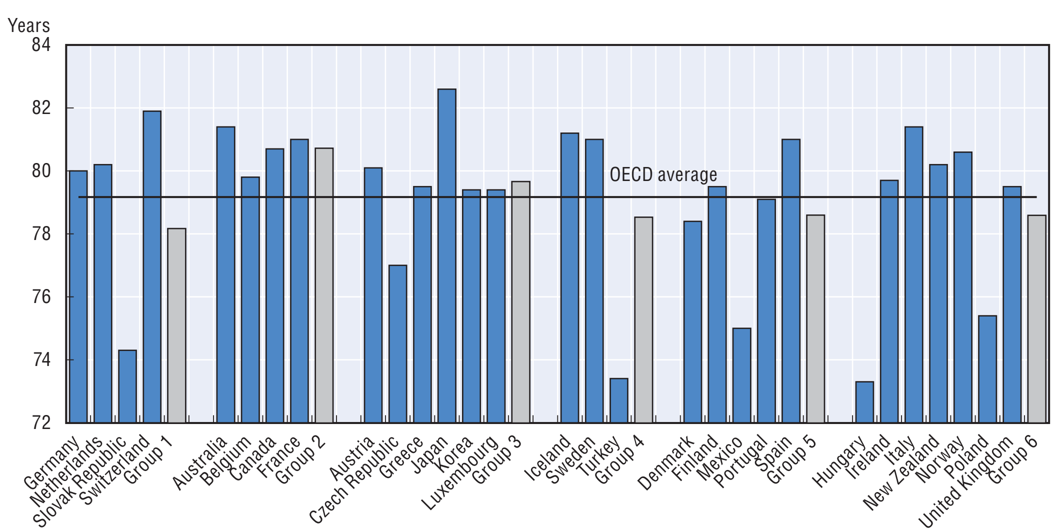
Going beyond comparisons of efficiency scores, differences in outcome and spending levels across groups are worth noting:

- There is no clear pattern in life expectancy at birth across country groups and there are significant variations within groups (Figure 6.9), suggesting that no type of health care system is systematically better at raising the health status of the population.
- Inequalities in health status (Figure 6.10) are lowest in Iceland, the Netherlands and Sweden. They also tend to be low in countries relying most on private insurance for the basic coverage (Group 1), with the exception of the Slovak Republic. This probably reflects that Germany, the Netherlands and Switzerland have introduced equalisation mechanisms and regulations to mitigate the potential adverse impacts of insurance markets on equity.[6] It should also be recognised that health inequalities are largely driven by socio-economic factors and thus mainly determined outside the health care sector.
- Spending levels per capita (Figure 6.11) tend to be high in countries relying extensively on market mechanisms in managing the basic insurance coverage (Group 1) and in countries where private health insurance plays an important role for providing additional coverage (Group 2).
- Administrative costs tend to be higher in those countries relying most on private insurance (Groups 1 and 2) (Figure 6.12). At the other extreme, countries relying more on regulations and public providers tend to spend less on administration.[7] Within some groups, however, differences in administrative costs are significant. In particular, the very large administrative costs – 7% or more of total health expenditure in 2007 – in Belgium, France, Luxembourg, Mexico and New Zealand may well signal inefficiencies.

Figure 6.9. **Life expectancy at birth across and within country groups**

2007 or latest available year

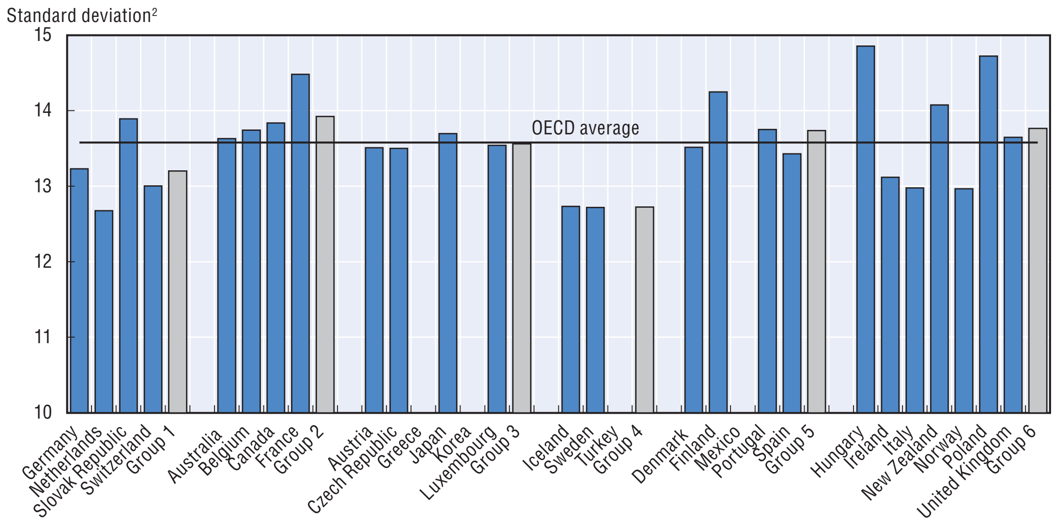


Source: *OECD Health Data 2009*, November.

StatLink http://dx.doi.org/10.1787/888932372735

Figure 6.10. **Inequalities in health status across and within country groups**

2006 or latest available year[1]



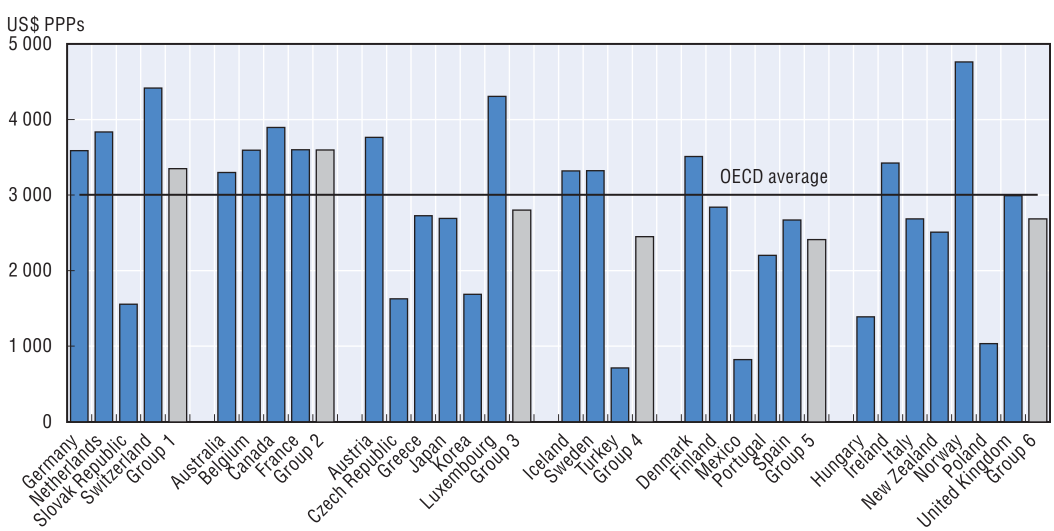
1. Data are not available for Greece, Korea, Mexico and Turkey.
2. Standard deviation in mortality ages for population older than 10.

Source: *OECD Health Data 2009*, November, and for the United States, *Human Mortality Database (HMD)*, University of California, Berkeley.

StatLink http://dx.doi.org/10.1787/888932372754

Figure 6.11. **Total expenditure on health per capita across and within country groups**

2007 or latest available year

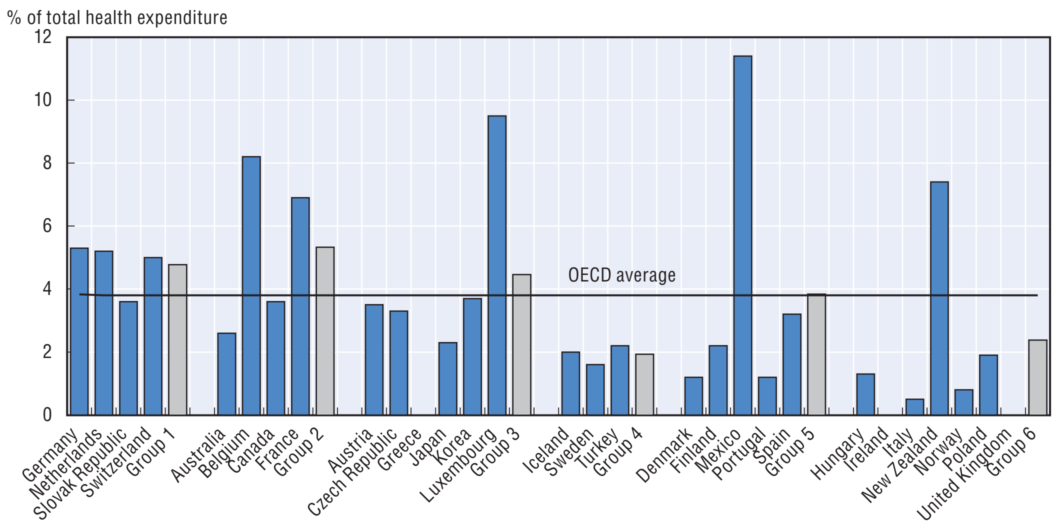


Source: *OECD Health Data 2009*, November.

StatLink http://dx.doi.org/10.1787/888932372773

Figure 6.12. **Spending on health administration across and within country groups**

2007 or latest available year[1]



1. Data are not available for Greece, Ireland and the United Kingdom. For Turkey, data are for the year 2000.

Source: *OECD Health Data 2009*, November.

StatLink http://dx.doi.org/10.1787/888932372792

Key policy messages for improving health system efficiency

The analysis suggests that no one type of health care system is clearly superior in delivering gains in health status for a given level of spending and socio-economic factors. Thus, a "big bang" approach – switching from one type of system to another – may not necessarily improve efficiency much. Nevertheless, useful reform avenues can be derived from international benchmarking.[8] The key policy messages emerging from across and within country-group comparisons are as follows:

- The *consistency of responsibility assignment* across levels of government could be reinforced in many countries to avoid duplication and ensure proper co-ordination of bodies involved in health care management. Care co-ordination problems often appear at the interface between providers (hospitals and out-patient care), the transition into long-term care being an area where problems are most intense in many countries (Hofmarcher *et al.*, 2007). And co-ordination problems may increase with the fragmentation of key health care decisions across levels of government. This should be an area for investigation in Austria, Australia, Canada, Denmark, Italy, Mexico, Poland, Sweden, Switzerland and the United Kingdom.
- *Gate-keeping* could be introduced or reinforced in some countries to reduce the large number of consultations (*e.g.* in the Czech Republic, Japan and Korea) or to contain spending on the in-patient sector (*e.g.* Belgium and Iceland).
- *Out-of-pocket payments* could be increased where they are low and combined with wide patient choice among providers since this may induce excessive demand, notably in the Czech Republic and Luxembourg.
- More *information on quality and prices* should be provided to users in many countries. In countries where there is an abundant choice of treatment, such information would enhance competitive pressures. Where less choice is available, it would allow benchmarking of providers and thus help spread best practices.

- The merits of *reforming provider payment schemes* should be investigated in many countries, both in the in-patient and out-patient sector. In some of the countries where physicians are compensated mainly through fee-for-services, the level of activity is high compared with other countries. Introducing an element of capitation – whereby physicians are paid according to the number of registered patients and not on the number of times patients require the physician's services – could help to reduce the number of consultations and improve the quality of preventive care (Germany, Japan and Korea are examples). In contrast, an activity-based component could be introduced or strengthened in some of the countries relying mainly on salaries (*e.g.* Greece, Iceland and Sweden) or capitation (*e.g.* Ireland and Poland) to increase the productivity of physicians. Adjusting the relative income level of health practitioners may be warranted in some countries – income tends to be low in some eastern European and Nordic countries. Combined with a stronger activity-based component of physicians' compensation system, this would reduce incentives for informal payments (*e.g.* Hungary) and for health personnel to migrate to high wage countries. Likewise, for hospitals, introducing a payment per case system in countries where it is absent may improve efficiency in the in-patient sector – notably in Greece, Iceland, Luxembourg, Portugal and Turkey.
- The *regulations concerning the hospital workforce and equipment* should be strengthened in some countries, but eased in others. Some of the countries where recently reformed hospital payment systems are now mainly based on activity have maintained rather tight regulations of hospital employment and equipment compared with their country peers. These regulations are likely to reduce flexibility to respond to the new set of incentives and may need to be relaxed (*e.g.* Belgium, France and Ireland). In contrast, regulation of the hospital workforce and equipment may need to be strengthened in some countries characterised by little use of market mechanisms for service providers, and an above average supply of hospital facilities (*e.g.* Finland and Iceland).
- Countries have different approaches to *priority setting*. Some only outline principles to guide prioritisation of health care provision. Others explicitly recommend the services which should be provided, sometimes setting up special bodies that establish priorities and monitor outcomes (*e.g.* the National Institute for Health and Clinical Excellence in the United Kingdom). While there is little evidence that establishing principles has significant effects on health care practice, priority-setting bodies with decision-making power seem to have been quite successful in some countries (Sabik and Lie, 2008). Within groups, the most efficient countries tend to be those with the most rigorous priority setting. Hence, better priority setting should be envisaged in those countries where there is no precise definition of the health benefit basket, no effective health technology assessment and no clear definition and monitoring of public health objectives.[9]
- The reasons for *inequalities* in health status vary across countries, and depend both on the health care system and general socio-economic conditions. The factors behind health inequalities should be investigated further so that policies can be developed to improve equality. Mexico and Turkey should move further towards achieving universal coverage. It would also be useful to assess whether inequities in access, and hence inequalities in health status, are created by extensive reliance on private health insurance to cover those services not, or only partially, covered by the basic insurance package (Canada and France), and/or high out-of-pocket payments (Finland, Hungary, Poland and Slovak Republic).

Notes

1. The projected increase in health care spending varies significantly across countries. The higher spending estimate refers to a cost-pressure scenario where prices in the health and long-term care sectors tend to rise in relation to other goods and services since productivity gains are limited. The lower spending estimate refers to a cost-containment scenario where policies succeed in containing such pressures.
2. Panel regressions and data envelopment analysis were used to derive efficiency scores, with comparisons across different specifications and robustness tests in both cases.
3. Internationally comparable data on health inequalities are scarce. A proxy measure of health inequalities can be the dispersion in the age of death among individuals (Edwards and Tuljapurkar, 2005; OECD, 2007). In 2006, this dispersion was lowest in Iceland, the Netherlands and Sweden.
4. Paris *et al.* (2010) present the information collected *via* the questionnaire in great detail. This wide-ranging dataset (269 mainly qualitative variables) was transformed into 20 core indicators on health policies and institutions that take values ranging from 0 to 6. These core quantitative indicators are presented in OECD (2010).
5. Linking performance scores and policy indicators should be done with care since reforms and increases in spending might require time to fully translate into better health outcomes. This applies to many countries including New Zealand and the United Kingdom.
6. Health inequalities, as measured by the dispersion in the age of death, are large in the United States where the reliance on private insurance is also very high.
7. For those countries financing health care spending mainly *via* tax revenues, the data may be slightly biased if tax collection costs are not included.
8. The OECD analysis has relied on the information on efficiency and the newly-developed policy indicators, as well as other data on health care resources, funding, activity and prices from the *OECD Health Database*, to identify how each country differs from its peers and whether policy levers exist to improve consistency in policy settings and thus efficiency. OECD (2010) presents a summary of this information in the form of individual country profiles and illustrates how to use this set of indicators for Finland and France.
9. In the United Kingdom and the Slovak Republic, rigorous priority setting is not matched by a high level of efficiency. This may reflect fairly recent improvements in priority setting, which were undertaken as a response to unsatisfactory performance.

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