Economic Policy Reforms

Going for Growth

2007

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Structural Policy Indicators and Priorities in OECD Countries

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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 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. 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 each other's successes and failures 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 2006 issue, this leaves out some important dimensions of well-being. For instance, while a high GDP per capita tends to make for better health and education outcomes, it is not sufficient to ensure social cohesion, even if higher employment helps. However, for economic policy purposes, GDP per capita and employment better approach well-being than any other available indicators.

Going for Growth *is the fruit of a joint effort across a large number of OECD Departments, including for this year's thematic chapters, Economics; Employment, Labour and Social Affairs; and Financial and Enterprise Affairs.*

Editorial

Recent economic developments have been propitious in many OECD countries, notably where GDP per capita is far below the best performers. In Japan and Korea growth has retained momentum, while in those European countries that were lagging behind, the recovery has been strong and is potentially sustainable over the next few years.

This improvement largely stems from cyclical factors, with the European recovery finally taking hold following a series of false starts. But to some extent it also reflects deeper progress achieved in the area of labour and product markets. Despite subdued growth, Europe overall has enjoyed sustained job creation, with the rate of "structural unemployment" falling by a full percentage point over the past few years, while product markets were significantly liberalised.

From the perspective of pursuing structural reforms, this welcome improvement in short-run economic prospects has ambiguous consequences: a strong recovery makes reforms both easier to implement and seemingly less necessary to undertake, since the threat of major difficulties is fading for a while. This is confirmed by recent OECD research, summarised in our special chapter on the "political economy of structural reforms".

Temptations to ease up on reforms should undoubtedly be resisted. In Continental Europe and Asian OECD members in particular, enhanced competition in product and financial markets are needed to boost productivity and long-term growth. Reforms on that front could also shift the composition of national income away from business profits into higher labour incomes and employment.

Last year's issue of Going for Growth *amply documented the growth dividends accruing from further financial market liberalisation and good innovation policies. This year's issue features two special chapters on product market competition.*

The first one attempts to quantify the benefits from increased product market competition in terms of innovation and productivity. It is no coincidence that the United States and Northern Europe, who started early to open up their product markets to competition, benefited most from the new information and communication technologies. OECD research suggests that open product markets stimulate innovation by pushing companies to catch up on the competition or to take the lead. Areas where further progress is needed in many OECD countries include dismantling barriers to competition in the energy, transport and communication sectors, as well as professional services, not to mention agricultural markets OECD-wide. Easing formal or informal restrictions to foreign ownership in countries such as Japan, Korea or Mexico is also called for.

The second chapter on product markets deals with the policies influencing competition across OECD countries and the institutions that drive them. It lays out some of the challenges and complexities facing those in charge of promoting greater competition. It stresses that enforcement of competition law is weak in some countries and that regulations still limit competition in many sectors, notably network industries. It also serves to highlight the importance of independent and powerful regulators, well-endowed with economic expertise.

Notwithstanding the intricacies of, and obstacles to, product market reforms, more difficult challenges face OECD countries in the areas of labour markets and education.

Granted, unemployment has receded over the years in many OECD countries. Tangible progress was recently made too in curtailing incentives for early retirement, translating into greater participation of people in their fifties and sixties.

Even so, employment rates remain low in parts of Continental Europe. And in most OECD countries, labour market performance has been a source of continued concern, with worries focused more and more on a perceived rise in earnings inequalities. Indeed, new information technologies and competition from large emerging economies are seen as exerting a negative influence on the jobs and incomes of the less-skilled workers, while boosting the prospects of the higher-skilled ones. In the United States, this may indeed have contributed to a marked polarisation in labour income gains, with only modest or no increases available for the bottom half of the wage distribution. Elsewhere, it may have worsened employment prospects in those countries where domestic labour market institutions were already deficient.

In a world where skills are becoming increasingly important, education systems have an essential role to play in equalising and raising opportunities, starting from early childhood education, the coverage of which often remains inadequate. Too many youngsters are also dropping out from secondary education without adequate vocational skills in various English-speaking and Central European countries. At the same time, raising tertiary graduation rates is still a common objective in the OECD at large. The challenges facing tertiary education are particularly daunting in Continental Europe where both substantially higher funding and much stronger managerial autonomy for universities are needed.

Labour market reforms are also required in many member countries to achieve full employment and overcome the "insider/outsider" divide. Following the recent revisiting of the OECD Jobs Strategy, *a special chapter is devoted here to those reforms.*

It is of course much easier to recommend labour market reforms than to implement them. One of the roadblocks obstructing successful reform lies with the widespread perception that they are just one more negative shock, on top of the ones brought on by the new globalised world. However, it should be clear by now that strategies that rely on reforming by stealth and at the margins of the labour market have failed. They did little to restore full employment and most likely increased precarity at work.

In fact, lack of reform has often worsened perceived insecurity, depressing household confidence. Reform sluggishness is understandable, given that adapting to rapid economic change can be a tall order. But it is also paradoxical, since the effectiveness of good labour market policies in various OECD countries is there for all to see and emulate. This is the case for active labour market policies and unemployment compensation, which can and should be designed so as not to trap recipients into inactivity while providing them with adequate income. It also holds for tax wedges and the cost of labour, which should not bar unskilled youth from employment. Taking advantage of existing best practice with regards to making-work-pay policies, more progress could be achieved as well to reduce in-work poverty and allow parents to better combine employment and family responsibilities.

In a global context where labour market outcomes, in terms of income and job quality, might become more and more polarised, it is important that labour market institutions do not unwittingly aggravate such trends. Alas, this may actually be the case in the crucial area of employment protection legislation. In many countries, too stringent protection for permanent employees has been offset by increasingly flexible modalities for temporary contracts. This has most likely contributed to labour market duality in Continental Europe. At the same time, the divide between insiders and outsiders has also worsened in Japan and Korea.

In countries such as France, Germany and Spain, with stringent employment protection legislation for permanent workers, youngsters and women are crowded out from employment and suffer from erratic career paths. Experience from various other European countries suggests ways to level the *playing field. Specifically, it points to reforming permanent contracts to make the costs of firing less unpredictable to employers while also providing income support and efficient re-employment services to workers in the event of lay-off.*

At the end of the day, why does good practice not always spread to countries where policy changes are badly needed? One reason may be that in these countries reform is perceived, often wrongly so, as a threat to social cohesion and deeply held values. Our empirical research nonetheless shows that this need not be the case. But, quite aside from any philosophical objections to market-oriented reforms, this may also reflect resistance from those who fear they may lose from change. Indeed, economic analysis suggests that while market-oriented reforms help boost global incomes, they may also induce losses for some people, at least in the absence of offsetting compensation.

Because they take time to materialise and are often diffuse, gains from reforms are perceived as uncertain. By contrast, those who stand to lose from change can easily identify themselves and unite to block reforms, thus leading to "the tyranny of the status quo". The difficulties confronting collective action in the reform area are well illustrated in our special chapter on the "political economy of structural reforms", which suggests that crisis is the main driver for institutional change. What would be needed, rather, is timely reform to avoid situations where finally the cost of inaction becomes so manifestly prohibitive that it dwarfs the short-run costs of reform.

On a brighter note, our empirical research suggests that smaller countries may be more alert and adept at introducing timely reforms. The same would seem to hold where political systems are conducive to government stability or where the fiscal position is strong enough to allow adequate compensation for losers.

Some reforms may also be easier to carry out than others: liberalising financial markets, international trade and, to some extent, product markets seems politically less sensitive than labour market reforms. Historically, such reforms have indeed been implemented first. This may also reflect the fact that, as already mentioned, financial, trade and product market reforms can grease the wheels of labour market reforms, since they contribute to shifting part of foreign and capital incomes to wage earners.

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

ISO country code	Country name	ISO currency code
AUS	Australia	AUD
AUT	Austria	EUR
BEL	Belgium	EUR
CAN	Canada	CAD
CHE	Switzerland	CHF
CZE	Czech Republic	CZK
DEU	Germany	EUR
DNK	Denmark	DKK
ESP	Spain	EUR
EU	European Union (15 members prior to 2004 enlargement)	n.a.
FIN	Finland	EUR
FRA	France	EUR
GBR	United Kingdom	GBP
GRC	Greece	EUR
HUN	Hungary	HUF
IRL	Ireland	EUR
ISL	Iceland	ISK
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
SVK	Slovak Republic	SKK
SWE	Sweden	SEK
TUR	Turkey	TRL
USA	United States	USD

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PART I

Taking Stock of Structural Policies in OECD Countries

As a general rule, the cut-off date for information used in Part I is end-2006.

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Economic Policy Reforms
Going for Growth

PART I

Chapter 1

Structural Policy Priorities: An Overview

A large number of OECD countries have failed to narrow the gap in GDP per capita vis-à-vis *the leading countries over the past decade, calling for a re-assessment of the main policies having an impact on the key growth drivers. This chapter provides an overview of broad trends in growth performance over the recent past and the policy priorities that have been identified in each country to address specific performance weaknesses. Given that high unemployment and low labour force participation remain a major preoccupation in many Continental European countries, measures to improve the labour market performance account for the majority of policy priorities in these economies. For lower-income countries, as well as a few high-income countries, raising productivity is the main challenge and hence priorities tend to focus more on liberalisation of product markets, especially in network industries and services. English-speaking countries have generally good labour market performance, but have in common the need to raise the level of skills, in particular via an improvement of secondary education.*

Introduction

Differences in material living standards across OECD countries reflect in part different structural policy settings. Relatively low income per capita and failure to converge on the highest-income countries can therefore be signs of policies not being as growth-friendly as they could be. Successive empirical studies by the OECD have sought to identify the policy levers that influence GDP per capita and its growth. As part of these exercises, indicators have been developed that summarise performance in key components of GDP per capita and the stance of related policies in a consistent way across countries and over time.

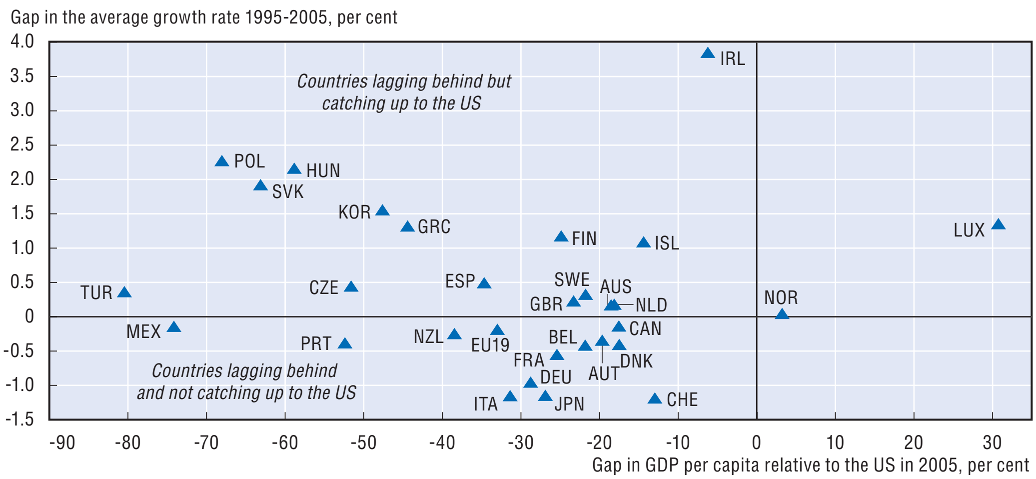
As in the 2005 *Going for Growth* assessment, this issue employs these indicators and studies to identify policy priorities to raise GDP per capita based on international benchmarking of performance and policies. This chapter provides an overview of broad trends in growth performance over the recent past and the policy priorities that have been identified to address specific performance weaknesses. The policy priorities are discussed in greater detail in the country notes in Chapter 2.

Growth performance in OECD countries: Key stylised facts[1]

Only around half of OECD countries have made some progress towards converging on the living standards of the benchmark country (United States) during the past ten years (Figure 1.1).[2] Relative living standards did improve in Ireland and a few lower-income

Figure 1.1. **GDP per capita levels and growth rates**

Gap *vis-à-vis* the United States[1]



1. The average growth rate of GDP per capita is calculated on the basis of volumes data from national accounts sources. The level of GDP per capita is calculated on the basis of 2005 PPPs. 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. Data for Greece do not take into account the 25 per cent upwards revision to the level of GDP announced in 2006.

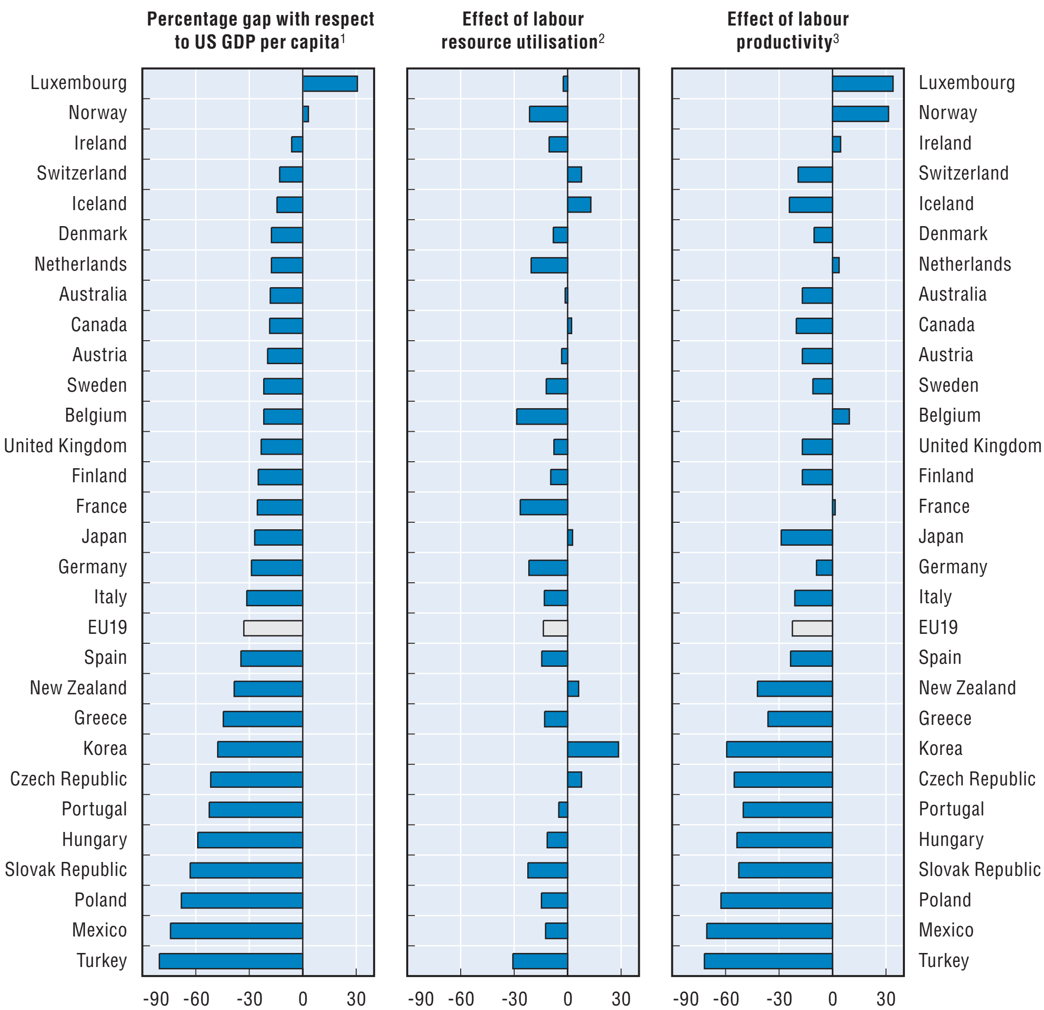
Source: OECD, *National Accounts of OECD Countries*, 2006; and *OECD Economic Outlook*, No. 80.

StatLink: *http://dx.doi.org/10.1787/404377252176*

countries, but the gap remained largely constant for the two OECD economies with the lowest income levels. Material living standards exceed those in the United States only in Luxembourg and Norway.[3]

The gap in GDP per capita *vis-à-vis* the benchmark country can be broken down into contributions from labour productivity and labour utilisation. The GDP gap in several Continental European countries relative to the United States is mostly accounted for by low labour utilisation (Figure 1.2). This reflects weak labour-force participation, often combined with short working hours and high unemployment. And, although measured labour productivity is often close to that in the United States in these countries, this is partly due to a compositional effect, the relatively low employment rates of the unskilled workers

Figure 1.2. **The sources of real income differences, 2005**



1. Based on 2005 purchasing power parities (PPPs). 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. Data for Greece do not take into account the 25 per cent upwards revision to the level of GDP announced in 2006.
2. Labour resource utilisation is measured as total number of hours worked divided by the population.
3. Labour productivity is measured as GDP per hour worked.

Source: OECD, *National Accounts of OECD Countries*, 2006; *OECD Economic Outlook*, No. 80; and *OECD Employment Outlook*, 2006.

StatLink: *http://dx.doi.org/10.1787/253146416837*

showing up in comparatively high average output per person employed and per hour worked. A recent study suggests that measured labour productivity would be as much as 15% lower relative to the United States in some countries if employment rates and average hours worked were the same (Bourlès and Cette, 2005).[4]

In other countries, the labour-productivity gap explains more of the weakness of GDP per capita compared with the benchmark country. Low output per hour worked accounts for more than the whole, or most, of the GDP-per-capita gap in Switzerland, Iceland, Korea, Japan and non-US English-speaking countries. Labour productivity is also the main factor behind the shortfall in GDP per capita in lower-income economies, although labour utilisation is also typically well below the level in the benchmark country due to low participation and, in some cases, high unemployment. In some of the Nordic countries (Denmark, Finland and Sweden), the labour-productivity gap contributes as much to the lower level of GDP per capita compared with the United States as does lower labour utilisation, with the latter reflecting essentially low average hours worked per worker.

Areas of policy priorities

To address countries' performance weaknesses in terms of labour productivity or utilisation, policy priorities have been selected on the basis of standardised criteria (Box 1.1). The summary of the policy priorities below first covers measures aimed at correcting weaknesses in productivity performance and then those that are intended to improve labour utilisation (Table 1.1). However, it should be kept in mind that a policy reform selected with a view to improve performance in one area may also have beneficial effects in the other area.

Policies to improve labour productivity performance

Labour productivity can be stimulated by policy settings that are conducive to profitable investment in physical capital (including information and communication technologies) and human capital, as well as in research and development. A policy area of particular relevance in this context is product market regulation, such as regulatory barriers to competition in product markets in the form of state control, administrative or legal barriers to firm entry or international trade and foreign direct investment (FDI) (see Chapters 5 and 6). Indeed, given the potential efficiency gains, including stronger innovation activity, from exposing the business sector to strong competitive pressures, these are identified as one of the prime areas of policy priority to boost labour productivity.[5] Another policy area of major relevance for improving productivity performance is related to human capital development.

Product market regulation

Better recognition of the importance of strong competition in product markets for productivity performance has been reflected in moves to ease restrictions in this area in recent years. Under persistent pressure from internal market completion, further progress has been made in EU countries – especially newer member states from Central Europe – with respect to easing of entry controls and reduction of state control, in particular in major network industries. Furthermore, even though the new Services Directive agreed in early 2006 falls short of initial ambitions, it should provide some additional stimulus to the integration of markets for services. Outside Continental Europe, product market regulations have generally been less stringent and some progress has been made in the recent past, especially with respect to reducing barriers to entry, strengthening competition legislation and easing controls on FDI.

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Box 1.1. **2007 Going for Growth: purpose and principles**

The purpose of this structural surveillance is to identify, for all individual countries and the European Union, five policy priorities most likely to boost the growth of GDP per capita in the future.* Three of these policy priorities are based on internationally-comparable indicators of performance and policy settings, confirmed by country-specific knowledge. The additional two priorities are not necessarily supported by indicators but draw on country-specific expertise in order to capture important policy areas that cannot always be assessed on the basis of quantitative indicators.

The starting point for the selection of indicator-based policy priorities is a detailed examination of labour utilisation and productivity performances so as to uncover specific areas of relative strengths and weaknesses (see Annex 1.A2 for further details of the methodology). The performance indicators are juxtaposed with a broad set of policy indicators (see Chapter 3), all of which have been shown to have an impact on the relevant aspect of performance, with the aim of identifying cases where performance and policy weaknesses appear to be linked. More specifically, in order to avoid a one-size-fits-all approach to policy reform, a deviation from a growth-friendly practice in a particular policy area is considered a candidate for priority selection only if a weak performance is also identified in an area that is affected by the policy in question. When there are more than three candidates for indicator-based policy priorities, the list is narrowed down by selecting the candidates that will have the strongest effect on GDP per capita according to previous OECD studies.

The current exercise has been broadened to include policies to encourage innovation activity in addition to the policy areas previously covered, *i.e.* essentially labour and product market policies, supplemented by some policy/performance indicators for health and education. The 2006 edition of *Going for Growth* established policy recommendations to strengthen innovation for all OECD countries. They are incorporated among the priorities here to the extent that they are assessed to be a priority to raise economic growth according to the above selection criteria. Some of the policy levers that directly affect productivity and labour utilisation also have a significant effect on R&D intensity, and thereby on productivity. Where such policies are selected as a priority to pursue general productivity goals and employment objectives, they will therefore also have beneficial effects via innovation activity.

* The selection of the same number of priorities for all OECD countries has been motivated by the desire to identify policy reforms that help improve everyone's performance, the better-performing economies included, and to ensure a certain degree of equality of treatment across member countries. However, this implies that for less-well performing countries with policy settings deviating from best practices in many areas, important policy priorities will be left out. Conversely, the priorities identified in countries with generally good performance may not always be seen as pressing issues.

Despite broad trends towards privatisation of public enterprises and opening of markets, a significant number of countries still have shortcomings in productivity performance that appear related to strict regulation in some specific sectors. To improve productivity performance, including via stronger innovation activities, it is a priority to boost competition in those sectors that have so far remained largely sheltered. More specifically:

- Regulatory barriers to competition in network industries should be lowered in Australia, Austria, Canada, France, Germany, Greece, Ireland, Korea, Mexico, Netherlands, Poland, Portugal and Switzerland. This is particularly pressing in the energy sector (gas and electricity) and, to a lesser extent, transport and communications (telecoms and postal services). Measures to strengthen competition in these industries include reducing ownership restrictions and other barriers to entry, and facilitating third-party access to the network component.

- Regulatory barriers to competition should also be lowered in professional services and/or retail trade in Austria, Belgium, Canada, France, Germany, Japan, Luxembourg, Netherlands, Poland and Spain.
- Efforts to reduce the complexity or opacity of rules and procedures to obtain licenses and/or the administrative burden on start-ups need to be pursued in the Czech Republic, Denmark, Korea and Turkey.
- Easing state control of business operation in various sectors, either via a reduction in direct ownership or a phasing-out of price controls remains a priority in Finland, Iceland, Italy, Mexico, Norway and Poland.
- Restrictions on foreign ownership and other measures discouraging FDI inflows should be further reduced in Canada, Iceland, Japan, Korea and Mexico.

Markets for agricultural products remain highly distorted in most OECD countries, resulting in misallocation of resources at the domestic level and limiting growth opportunities in the non-OECD area. Although measures have been taken to shift the composition of support towards less trade-distorting forms, significant reforms in this area have been on hold in recent years, pending the outcome of the WTO Doha round. After being officially suspended in July 2006, tentative discussions to re-start trade negotiations have been on-going during the first weeks of 2007. It is important that multilateral negotiations are successful in bringing significant reductions in current distortions. Reform of agricultural support is identified as a priority for the European Union, as well as for Iceland, Japan, Korea, Norway, Switzerland and the United States. Such reforms should aim both at reducing the overall level of subsidies, and at diminishing the distortionary impact of a given support level by further de-linking it from production.

Human capital

The accumulation of skills and competencies through high-quality education systems has long been recognised as a fundamental driver of growth, not least via its impact on the creation and diffusion of new technologies. However, while both quantity and quality of output from the education system are important, there is still insufficient understanding of the policy settings that contribute to good outcomes in these areas. In absence of direct policy indicators with clear links to outcomes and unlike the practice applied for identifying priorities in other areas, priorities for education reforms are selected on the basis of relative country outcomes such as educational attainments (graduation rates) at the compulsory and tertiary levels and the proficiency of 15-year-olds in specific fields (PISA scores).

Although reforms have taken place in recent years, including changes in the curricula, the establishment of nation-wide educational standards and improvements in access to vocational education, strengthening human capital remains an important area of policy priorities in many countries:

- At the primary or pre-school level, the focus should be on increasing the educational content for school entrants (Denmark) and raising the coverage of early childhood education (Germany, Ireland, Slovak Republic, Turkey and the United States).

- At the secondary level, priorities include reducing the number of early school leavers by strengthening vocational education, raising support for disadvantaged groups and/or curriculum development (Australia, Hungary, Iceland, Ireland, Luxembourg, New Zealand, Slovak Republic and the United Kingdom); and enhancing the standards of education by increasing autonomy and accountability of schools (Germany, Slovak Republic, Turkey and the United States) and by raising the share of non-wage spending combined with modernising curricula (Mexico and Portugal).
- At the tertiary level, an increase in graduation rates remains a common objective, with specific policy prescriptions including raising the level of funding – not least via student fees – and/or granting universities more autonomy in the management of human resources and programmes (Austria, Czech Republic, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Poland, Portugal, Slovak Republic, Spain and Sweden).

Other policy areas

A number of priorities aimed at improving overall economic efficiency concern specific areas that are not covered by indicators. For instance, several countries could raise the cost-efficiency of public services delivery with a reform of public administration (Czech Republic, Hungary, Iceland, New Zealand, Portugal and the United Kingdom), while reforming the tax system is a priority in Canada, Mexico, Portugal and the United States. Also, infrastructure bottlenecks, especially related to transport, require specific policy attention in Ireland, New Zealand, Poland, and the United Kingdom. Moreover, specific measures to strengthen the efficiency of the innovation system, including greater competition for public funds for innovation purposes are recommended for a few countries (Ireland, Japan and Korea). Finally, reform of the housing market (or housing loan systems) is a priority in Denmark, Iceland, Netherlands, Slovak Republic and Sweden, with the aim of *inter alia* reducing excessive investment in residential structures but also to improve labour mobility.

Policies to improve labour resource utilisation

Given the relative under-utilisation of labour resources in some Continental European countries, policy priorities to raise participation and employment rates, as well as average hours worked, are more concentrated on these countries. These policies can be organised into three broad categories: taxation; benefits and income support programmes; and labour market regulation.[6]

Average and marginal taxation on labour income

Given the potentially adverse effect of high tax wedges on employment and on efficiency, including via their influence on the size of the shadow economy, several countries have reduced average or marginal tax wedges on labour income over the past two years. However, further reductions are still judged to be a priority to raise labour utilisation in most of these countries, and a number of others have yet to start the process to reduce taxes on labour income:

- In many cases, reforms should aim at lowering tax wedges in general, or employer social security contributions in particular, in order to boost participation rates and/or job creation (Belgium, Czech Republic, Finland, Germany, Hungary, Italy, Poland and the Slovak Republic).
- In other cases, the emphasis should be cutting marginal tax rates so as to stimulate hours worked (Australia, Austria, Denmark and Sweden).

Policy priorities in this area are accompanied by supplementary recommendations on how to finance lower taxes. Thus, it is recommended to cut elements of public spending (Belgium, Czech Republic and Hungary), reduce tax expenditures (Austria, Germany and Italy) and shift the tax burden to other areas (Denmark, Finland, Slovak Republic and Sweden). Restraining spending on health and social benefits is specifically recommended for Germany. Indeed, given already high health care costs and associated high non-wage labour costs, achieving efficiency gains in the provision of health care is also an important objective in Switzerland and the United States.

Social benefits

Notwithstanding some reforms in recent years, the design of pension and other income-support systems contributes to low participation rates among older workers in many countries. As measured by the implicit tax on continued work,[7] the extent of the disincentive was very high in some countries in 2005, in particular for workers in their late 50s and early 60s. As a result of such employment-adverse policy-settings, corrective measures are a priority for several countries. More specifically, pension schemes should be made more actuarially neutral so as to increase the net financial benefit for older employees of working additional years (Greece, Luxembourg, Norway, Slovak Republic, Spain and Turkey) and alternative routes to early retirement should be reformed with a view to tightening eligibility conditions and eliminating the disincentives to remain in the labour force (Austria, Belgium, Finland and France).

In many countries, the tightening of other early exit routes from the labour market has coincided with a sharp and steady increase in the number of disability benefit recipients, especially among older workers. In Australia, Denmark, Hungary, Netherlands, Norway, Sweden, United Kingdom and the United States, the share of the working-age population receiving benefits, which was already high in the late 1990s, continued to rise during the first half of the current decade.[8] This has occurred even though most of the countries introduced measures to stem the flow of new entrants into the programmes via a tightening of controls, greater use of temporary entitlements and by providing job-search assistance to those with residual work capacity. Accordingly, reform of disability benefit programmes is seen as a priority in these countries, and in some this should be accompanied by reforms of the sickness benefit system.

High levels of income support to unemployed workers reduce incentives to search for new work, especially when such benefits are accessible for a long period with relatively few conditions. Reforms in this area over the past couple of years have generally focused on strengthening activation measures, including a tightening of eligibility and work-availability conditions and increasing the emphasis on job-search assistance, and, in some cases, the introduction of “in-work” benefits. Unemployment benefit reforms are regarded as being a priority for a few countries. In Belgium, Germany, Luxembourg and Poland, entitlement conditions for continued receipt of unemployment benefits after a long spell of joblessness should be tightened along with an improvement in the effectiveness of job-search assistance and other activation measures. In Finland, financial suppport available to the long-term unemployed should be reduced. Also, the income support system in Canada should be reviewed, with a view to limiting the scope for firms engaged in seasonal and temporary activities to benefit unduly from the system.

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In a similar vein, the full-time participation of women in the labour force can be hampered by high implicit tax rates on joining the labour force or extending hours worked, especially when costs for child-care are taken into account. In order to make work pay for women with children and with relatively low earning potential, tax disincentives to full-time participation should be lowered and/or access to affordable child-care facilities improved in Germany, Ireland, Korea, Netherlands, New Zealand, Switzerland and the United Kingdom.

Labour market regulation and collective wage agreements

Strict job protection regulation reduces the dynamism of the labour market, with adverse effects on the employment prospects of certain groups and on productivity performance. Reform strategies in this area have generally involved the easing of regulations on temporary contracts but no relaxation for permanent contracts, and the exclusion of certain groups from specific provisions of the law (Box 1.2). While this may have raised employment in the short run, it has increased the duality of the labour market, with potential negative effects on efficiency in the long term as well as on working conditions for some workers. To counter the adverse effects of employment protection legislation on labour utilisation of certain groups and growth in general, reforming it is a priority, especially for regular contracts, in the Czech Republic, France, Greece, Japan, Luxembourg, Portugal, Spain, Sweden and Turkey. Reform options include moving towards a single contract where protection grows with seniority, *e.g.* by requiring employers to pay regular contributions to individual separation accounts that can be accessed in the case of layoffs, and reducing judicial uncertainty related to vague definitions of unfair dismissal in legislation.

High statutory minimum hourly labour costs, *i.e.* minimum hourly wages and social security contributions at that wage level, can reduce employment prospects of some groups, notably young people. Prompted by such concerns, some European countries have sought to reduce social security contributions on low earnings rather than reduce minimum wages relative to the average. Reducing relatively high minimum labour costs is seen as a priority for a few countries. More specifically, the minimum cost of labour should be reduced in France, Greece and Turkey by limiting the adjustment of minimum wages to below increases in average wage levels, lowering employers' contributions and/or introducing distinct minimum wages for young workers.

Extension of collective contracts to cover workers and employers not party to the original settlement risks establishing too high labour costs in some industrial segments and regions. More generally, to allow for better alignment of labour productivity and costs at the local level, it is a priority to reform bargaining arrangements in Australia, Belgium, Finland, Italy and Spain.

Summary

Given that priorities are identified based on performance weaknesses, their distribution across policy areas generally reflects the differences observed in the performance profiles.[9] Moreover, country groupings in terms of policy priorities broadly match those based on broad performance outcomes. For instance, policy priorities aimed at boosting overall labour resource utilisation remain more concentrated in Continental European countries. For countries with a large gap in GDP per capita, as well as in Japan and Switzerland, raising productivity is the main challenge and hence priorities tend to focus more on liberalisation of product markets, especially in network industries and services. English-speaking countries

Box 1.2. **Beyond the EPL indicator – The size threshold for protection**

The 2006 up-date of the indicator of employment protection legislation (EPL) shows no change relative to 2003 in most countries, suggesting an absence of reforms over the period. However, changes in EPL made in a few countries, such as Australia, France, Germany and Sweden, are not captured by the OECD indicator. The main reason is that while the indicator is based on the extent of protection for a "typical" worker, reforms made in recent years have often taken the form of new clauses targeted at specific groups of workers, in particular those employed in small firms. Such size-based exclusion has a longer history in some other OECD countries. The table below shows the types of regulations and the share of private-sector employees exempted due to the small size of their workplaces for the countries where this type of information was available.

Exemption from certain types of EPL protection related to the size of workplace

	Types of protection concerned	Share of private-sector employees affected (%)
Australia	Unfair dismissal: the Workplace Relations Amendment Act of 2005 introduced a workplace threshold of 100 for protection for incorporated enterprises and excluded unincorporated enterprises under the federal system.	34
France	Trial period: the CNE ("*contrat nouvelles embauches*"), introduced in 2005, extended the trial period for workers in firms with less than 20 employees to two years. During these two years, employees hired under the CNE can still enjoy a considerable degree of protection.	29
Germany	Unfair dismissal: the workplace threshold for protection was raised from 5 workers to 10 in 2004.	19
Italy	Reinstatement and compensation: firms with fewer than 60 employees (or establishments with less than 15) can convert their reinstatement obligation into compensation equal to 15 months' wages. There is also a two-tiered compensation rate based on the same threshold.	33
Korea	Labour Code: most parts apply from 5 permanent employees.	20
Portugal	Unfair dismissal and notification procedures: micro-enterprises with up to 9 workers are not required to implement certain unfair dismissal remedies, such as reinstatement in case of employees in managing positions, and are not obliged to justify the reason of dismissal to works councils.	39
Slovak Republic	Temporary employment: small businesses with less than 20 employees can renew temporary contracts over 3 years.	35
Sweden	Unfair dismissal: the "last-in-first-out" rule no longer applies to firms with up to 10 employees.	n.a.
Turkey	Labour Act: does not apply to workers in firms with less than 50 employees in the agriculture and the forestry sectors.	n.a.

have generally good labour market performance, but raising the skills level in particular via an improvement of secondary education remains a common challenge. Finally, a large number of EU countries share the need to strengthen their higher-education systems in order to improve graduation rates and /or the quality of teaching and research performed.

On average across countries, between one and two of five priorities identified in *Going for Growth 2005* have been dropped in the current exercise. In the majority of cases that were dropped, some actions taken had already been reported in *Going for Growth 2006* or have been taken since then. Even though in many instances the reforms made have only partially addressed the identified weaknesses in the related policy settings, this has been enough to allow other policy areas to become more pressing issues. Furthermore, the extension of the exercise to the area of innovation, combined with an improvement in the set of indicators measuring policy areas already covered in the past, as well as a re-assessment of policy requirements, has resulted in the exclusion of some priorities, even though little or no action had been taken.

Notes

1. A more detailed review of the trends in growth performance and their sources is provided in Annex 1.A1. In absence of sufficient backward revisions available at the time of publication, the figures for Greece do not incorporate the major upward revision to national accounts announced by the authorities in the fall of 2006.
2. International comparison of economic performance measured in terms of GDP per capita and its main sub-components is facilitated by the use of a country as a benchmark or "numeraire". Owing to its size and position among the leading countries in terms of GDP per capita, the United States is a natural choice for such a numeraire.
3. GDP per capita in these countries is boosted by special factors: oil extraction in Norway and cross-border workers and the financial market in Luxembourg.
4. Bourlès and Cette (2005), "A comparison of structural levels of productivity in the major industrialised countries", *OECD Economic Studies*, No. 41.
5. Evidence presented in Chapter 4 indicates that more competitive product markets may also boost labour utilisation.
6. For a more detailed discussion of the policy determinants of labour market performance, see Chapter 4.
7. The implicit tax on continued work is equal to the change in pension wealth over a certain period. The pension wealth is defined here as the sum of the flow of discounted pension benefits (or other *de facto* retirement benefits) less contributions to such benefit schemes. See Chapter 5 of *Going for Growth* 2005 for more details.
8. More recently, the share has stabilised in some of these countries (*e.g.* Australia). Among other countries for which data are available, only a few (*e.g.* Italy and Poland) have achieved a substantial reduction in the number of claimants during the first half of the 2000s.
9. Measures to strengthen labour market performance account for over one-third of all priorities, while those related to product market regulation, trade and innovation account for around one quarter. Education policies also remain an important area of policy priorities (around 15% of total) with an even split between secondary and tertiary levels. The remaining priorities are accounted for by recommendations in various fields not covered by indicators, such as public sector efficiency, non-tariff trade barriers, public infrastructure and housing.

Table 1.1. **Structural policies and performance: proposed priorities**[1]

	Performance areas	
	Labour utilisation	Labour productivity
Australia	Continue reform of disability benefit schemes to encourage work by existing claimants with substantial work capacity. Strengthen employment prospects of lower-skilled workers by improving vocational education. *Phase out the current wage-setting system (award wages) to allow greater flexibility in wage bargaining.* *Further reduce effective marginal tax rates on low-income workers to encourage full-time work.*	Promote competition in network industries by encouraging greater regulatory consistency and market integration across states.
Austria	Reduce disincentives to work at older ages by limiting early retirement through unemployment benefits. *Strengthen incentives to work by reducing marginal taxes on labour income.*	Improve quality and efficiency of tertiary education by strengthening performance-based funding. Promote competition in network industries by reducing ownership restrictions and other barriers to entry. *Promote competition in services by reducing statutory regulation of trades and professions and abolishing compulsory chamber membership.*
Belgium	Reduce tax wedge on low-income workers to increase employment opportunities for this group. Reduce disincentives to work at older ages by reforming early retirement pathways. *Strengthen enforcement of job-search requirement by ensuring better coordination between placement agencies.* *Reduce geographical mismatches in labour markets by increasing the scope for individual firms to opt out of nation-wide sectoral wage agreements.*	Promote competition in retail distribution by further easing regulation on zoning and opening hours.
Canada	*Reduce inefficiency of the employment insurance system to allow for lower contributions.*	Promote competition in electricity markets by encouraging greater liberalisation and integration across provinces. Further reduce barriers to foreign direct investment to facilitate transfers of new technologies and management practices from abroad. Promote competition in professional services by reducing the number of regulated occupations and other obstacles to inter-provincial trade. *Further reduce taxation of firms' ownership of capital and harmonise effective tax rates across businesses to encourage private investment.*
Czech Republic	Stimulate hiring by cutting the costs of EPL for regular workers. Reduce the tax wedge on low-income workers to increase employment opportunities for this group.	Reduce administrative costs for start-ups to stimulate product market competition. *Raise public-sector efficiency by reforming the health care system and strengthening financial incentives for mergers at the municipal level.* *Raise funding for tertiary education by introducing a fee system backed by income-contingent student loans.*
Denmark	Cut disincentives to work longer hours by reducing marginal taxes on labour income. Refocus sickness and disability benefit schemes to encourage work by those with substantial work capacity. *Reduce housing subsidies and abolish rent regulation to minimise housing market distortion and facilitate labour mobility.*	Improve educational achievements to raise efficiency of the labour force. *Ease regulatory burden on business operations to stimulate product market competition.*
Finland	Strengthen work incentives by further reducing the tax wedge on labour income. Reduce implicit tax on continued work at older ages by reforming early retirement pathways. Reduce the incidence of long-term unemployment by tapering unemployment benefits with duration. *Promote greater flexibility in centralised wage agreements to expand employment opportunities.*	*Reduce the scale of public ownership to facilitate entry and stimulate product market competition.*

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Table 1.1. **Structural policies and performance: proposed priorities**[1] *(cont.)*

	Performance areas	
	Labour utilisation	Labour productivity
France	Reduce the duality of the labour market by cutting the costs of EPL regulation for regular workers. Stimulate labour demand for youth and low-skilled by allowing for a relative decline in the minimum cost of labour. *Reduce implicit tax on continued work at older ages by reforming the system of unemployment benefits.*	Promote competition in retail distribution and network industries by reviewing regulation concerning access conditions and pricing practices. *Improve quality and efficiency of tertiary education by introducing a fee system backed by income-contingent student loans.*
Germany	Strengthen work incentives by reducing the tax wedge on labour income. *Reduce disincentives to full-time female labour force participation by improving access to child-care facilities and lowering taxes for second earners.* *Strengthen incentives to move from welfare to work via more effective job placement and stricter conditionality.*	Raise overall human capital by improving efficiency of the education system. Promote competition in professional services and network industries by reducing regulatory barriers to entry.
Greece	Stimulate hiring of white-collar workers by reducing the cost of EPL for this group. Reduce disincentives to work at older ages by linking pension benefits to lifetime contributions. *Stimulate labour demand for youth by introducing a sub-minimum wage for young people.*	Promote competition in network industries by reducing ownership restrictions and other barriers to entry. *Improve quality and efficiency of tertiary education by strengthening performance-based funding.*
Hungary	Strengthen work incentives by reducing the tax wedge on labour income. Continue reform of disability benefit schemes to encourage work by those with substantial work capacity. *Reform tax and benefit systems to stimulate employment in the formal sector.*	Raise overall human capital by improving efficiency of the education system. *Raise public-spending efficiency by accelerating reform of public administration and by addressing weaknesses in budget planning.*
Iceland		Promote competition in the fisheries and energy sectors by reducing ownership barriers to domestic and foreign entry. Reduce producer support to agriculture, especially the most trade-distorting types. Improve graduation rates from upper-secondary education to raise efficiency of the labour force. *Raise public-sector efficiency by accelerating reform of public administration.* *Reduce government backing of bonds issued by the Housing Finance Fund to reduce housing market distortions.*
Ireland	Strengthen work incentives for second earners and lone parents by improving access to child-care facilities.	Promote competition in network industries by facilitating entry and access to network components. Raise overall human capital by improving funding and efficiency of the education system. *Improve governance efficiency of research institutions to strengthen innovation outcomes.* *Improve public infrastructure in a cost-efficient fashion to reduce bottlenecks.*
Italy	Strengthen work incentives by reducing the tax wedge on labour income. *Promote greater flexibility in wage bargaining by decentralising wage setting arrangements in the public sector.*	Promote greater competition for services by fully implementing recent reforms as well as the planned reforms of local government services. Improve quality and efficiency of tertiary education by reviewing the funding and governance of universities. *Improve corporate governance by implementing reforms of financial market supervision and bankruptcy procedures.*
Japan	Reduce the duality of the labour market by cutting the costs of EPL for regular workers.	Promote greater competition in retail and professional services by facilitating entry. Reduce producer support to agriculture, especially the most trade-distorting types. *Encourage innovation by improving access to venture capital and upgrading the education system.* *Reduce barriers to foreign direct investment to enhance transfers of new technologies and management practices from abroad.*

Table 1.1. **Structural policies and performance: proposed priorities**[1] *(cont.)*

	Performance areas	
	Labour utilisation	Labour productivity
Korea	*Strengthen labour force participation for women by improving access to child-care facilities.*	Promote competition in the non-manufacturing sector by reducing regulatory barriers to domestic and by removing obstacles to foreign direct investment. Reduce producer support to agriculture, especially the most trade-distorting types. Reduce administrative costs for start-ups to stimulate product market competition. *Improve the innovation system by strengthening intellectual property rights and industry-science linkages.*
Luxembourg	Reduce disincentives to work at older ages by linking pension benefits to lifetime contributions more closely. Strengthen incentives to move from welfare to work by tightening entitlement conditions to benefits. *Reduce the duality in the labour market by cutting the costs of EPL for regular workers.*	Improve educational achievement at the primary and secondary levels to raise efficiency of the labour force. *Promote competition in professional services by easing conduct regulation and licensing requirements.*
Mexico	*Shift burden of taxation towards consumption by broadening the value-added tax base.*	Improve education attainment and achievement at the compulsory level to raise efficiency of the labour force. Promote competition in industries by reducing ownership restrictions and other barriers to entry. Reduce barriers to foreign ownership to enhance technological transfers from abroad. *Strengthen investor confidence by improving the enforceability of contracts.*
Netherlands	Strengthen incentives to full-time labour force participation for low-income second earners by reducing their effective marginal tax rates. Continue reform of disability benefit schemes to encourage work by those with substantial work capacity. *Stimulate labour mobility by reforming residential zoning restrictions.*	Promote competition in network industries by facilitating entry and third-party access to network components. *Promote competition in retail services by easing restrictions on large-format stores.*
New Zealand	Strengthen incentives to full-time labour force participation for women by improving access to child-care facilities. *Raise public-sector efficiency through well-designed performance targets in health and education.*	Stimulate investment in the electricity sector by reducing regulatory uncertainties. Improve educational achievement, in particular among ethnic minorities, to raise efficiency of the labour force. *Improve the road-pricing system to reduce transport bottlenecks.*
Norway	Refocus sickness and disability benefit schemes to encourage work by those with substantial work capacity. *Implement the proposed pension reform to raise incentives to remain in the labour force at older ages.*	Reduce producer support to agriculture, especially the most trade-distorting types. Reduce the scope of public ownership in financial services and network industries to stimulate foreign investment and competition. *Promote greater competition in product markets by strengthening the independence of the competition authority.*
Poland	Strengthen incentives to work by reducing tax wedges and tightening unemployment support conditionality. *Increase labour mobility by improving transport and housing infrastructures.*	Reduce state control in various sectors to stimulate private investment and effective competition. Improve quality and efficiency of tertiary education by introducing a fee system backed by income-contingent student loans. *Promote competition in professional services and telecommunications by simplifying regulation and facilitating third-party access.*
Portugal	Reduce labour market segmentation and facilitate labour mobility by cutting the costs of EPL.	Improve education attainment and achievement at the compulsory level to raise efficiency of the labour force. Promote competition in network industries and services by reducing regulatory barriers to entry. *Raise public-sector efficiency by accelerating reform of public administration.* *Stimulate private investment by simplifying the corporate tax system and reducing compliance costs.*

Table 1.1. **Structural policies and performance: proposed priorities**[1] *(cont.)*

	Performance areas	
	Labour utilisation	Labour productivity
Slovak Republic	Reduce the tax wedge on low-income workers to increase employment opportunities for this group. Reduce disincentives to work at older ages by linking lifetime contributions to benefits more closely. *Reform housing markets to reduce distortions and facilitate labour mobility.*	Raise overall human capital by improving effectiveness of the education system. *Strengthen the development of market-based activities in the formal sector by improving the enforceability of law and contracts.*
Spain	Promote greater flexibility in wage determination by limiting the extent of administrative extension of collective agreements. Reduce labour-market duality by cutting the costs of EPL for regular workers. *Reduce disincentives to work at older ages by linking pension benefits to lifetime contributions more closely.*	Promote competition in retail distribution by reducing regulatory barriers to entry. *Improve quality and efficiency of tertiary education by granting universities more autonomy.*
Sweden	Refocus sickness and disability benefit schemes to encourage work by those with substantial work capacity. Strengthen incentives to work longer hours by reducing marginal taxes on labour income. *Reform housing policies to reduce distortions and facilitate labour mobility.*	Reduce the costs of EPL regulation to facilitate human resource management and stimulate innovation. *Improve quality and efficiency of tertiary education by raising incentives for students to start and complete university programme more rapidly.*
Switzerland	Strengthen incentives to full-time labour force participation for women by improving access to child-care facilities. *Promote competition in the provision of medical products and services to contain increases in health care costs.*	Promote competition in network industries by reducing regulatory barriers to entry. Reduce producer support to agriculture, especially the most trade-distorting types. *Review technical regulations related to traded products to stimulate cross-border trade and competition.*
Turkey	Stimulate employment of low-skilled workers in the formal sector by allowing for a relative decline in the minimum cost of labour. Stimulate hiring of regular workers in the formal sector and facilitate labour mobility by cutting the costs of EPL. *Reduce disincentives to work at older ages by gradually making the pension system actuarially neutral.*	Improve education achievement at the upper-secondary level to raise efficiency of the labour force. *Reduce administrative costs for start-ups to stimulate product market competition.*
United Kingdom	Strengthen employment prospects of lower-skilled workers by improving educational outcomes at the secondary level. Further reform disability pension schemes to encourage work by those with substantial work capacity. *Strengthen incentives to full-time labour force participation for lone parents and second earners by improving access to child-care facilities.*	Improve public infrastructure, especially for transport to further reduce bottlenecks. *Raise public-sector efficiency by strengthening incentives to pursue performance targets in publicly-funded services.*
United States	Limit increases in labour costs by reforming Medicare to restrain health care costs. *Shift burden of taxation towards consumption and broaden the tax base.* *Refocus disability benefit schemes to encourage work by those with substantial work capacity.*	Improve education achievement at the secondary level to raise efficiency of the labour force. Reduce producer support to agriculture, especially the most trade-distorting types.
European Union	*Improve intra-EU labour mobility by enhancing portability of pension and other benefit entitlements.*	Ease internal regulatory obstacles to cross-border trade and entry in services to reduce compliance costs for businesses. Promote greater competition in product markets by further reducing barriers to market contestability in network industries. Reduce producer support to agriculture, especially the most trade-distorting types. *Enhance competition in financial services by ensuring full implementation of the Financial Services Action Plan.*

1. Priorities in italics are not necessarily based on indicators.

ANNEX 1.A1

Broad Trends in Growth Performance

This annex provides a description of broad trends in growth performance in the OECD countries. It first provides a brief overview of trends in aggregate GDP growth. It then examines the two key components of GDP per capita: labour productivity and labour utilisation.

GDP per capita and income

Most OECD countries have not achieved over the past ten years the substantial convergence on the living standards of the United States seen in earlier post-war decades. Trend GDP per capita has grown markedly faster than in the benchmark country only in Greece, Hungary, Ireland, Korea, Luxembourg, Poland and the Slovak Republic. Trend growth in Mexico and Turkey has been mediocre over the past decade especially considering the large potential for these economies to catch up, although there have been some signs of improvement over the past five years. Strikingly, material living standards in France, Germany, Italy and Japan have not kept pace over the past decade with the trend increase in GDP per capita in the United States.

Convergence of GDP per capita is only a partial measure of the narrowing of the gap in living standards across countries. As discussed in the 2006 issue of *Going for Growth*, it measures income rather than wealth and even then it ignores incomes received from abroad or paid to foreigners. Nevertheless, the relationship between GDP and other measures of economic well-being, such as net national income, is close in all but a few notable cases. For instance, although Ireland has almost caught up with the level of GDP per capita of the United States, foreign investors now lay claim to a significant share of profits and therefore national income per capita has made less progress towards convergence. For the Czech Republic and Poland, the increase in net outward transfers of income over the past decade has also had a substantial effect in slowing the growth of national income relative to output. Changes in the terms of trade have had a material negative effect on the growth of real incomes in specialised ICT-producing countries (*e.g.* Finland, Korea and Sweden) – partly offsetting the impact that strong GDP growth performance has had on their well-being. In contrast, they have been beneficial over the past ten years for real income in resource-rich countries such as Australia and Norway.

Labour productivity

In most countries, the GDP-per-capita gap is largely explained by weaker productivity compared with the United States. This includes non-US English-speaking and Nordic countries, as well as lower-income economies. Even in the Continental European economies with measured labour/productivity close to the United States, it is likely that

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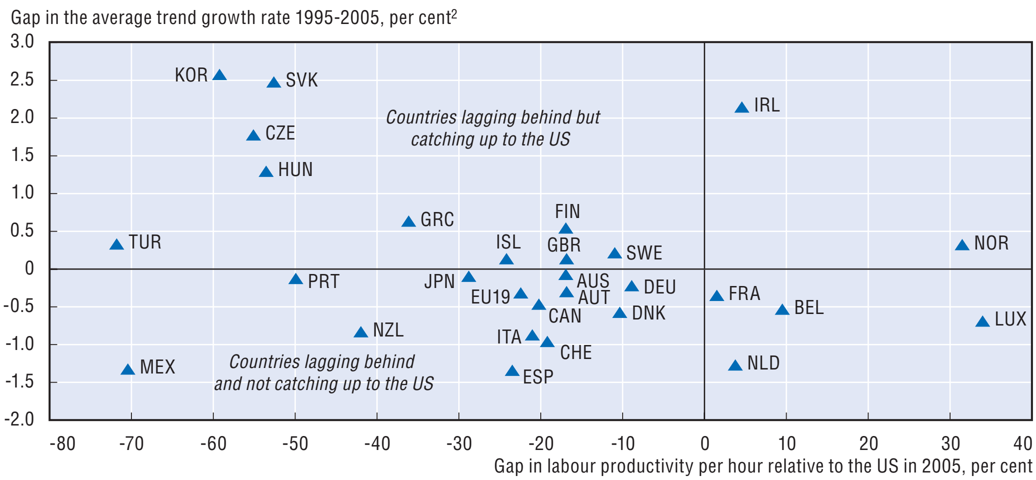
true productive capacity is lower taking into account low labour utilisation in these countries and lower-productivity workers being less likely to be employed (see main text).

Closing the gap in living standards with the United States over the past ten years, where it has occurred, has largely been achieved through relatively faster growth in labour productivity. To narrow the productivity gap over the past decade, countries have needed to make rapid improvements in output per hour as labour productivity in the United States accelerated from the mid-1990s and has accelerated further since 2000. Growth of output per hour has generally been fastest in countries with a low initial level of productivity and so the greatest potential to catch up (Figure 1.A1.1). However, the growth rate of labour productivity in even these countries still implies very slow convergence to the level of the benchmark country.* Labour productivity growth in Mexico has not even been sufficient to keep pace with the United States.

Figure 1.A1.1. **Labour productivity levels and growth rates**

Gap *vis-à-vis* the United States[1]



1. The average trend growth rate of labour productivity, measured as GDP per hours worked, is calculated on the basis of volumes data. Data for Greece do not take into account the 25% upwards revision to the level of GDP announced in 2006.
2. 1998-2005 for the Czech Republic, 1995-2004 for Mexico and Turkey; Poland is not included in the EU19, due to missing hours data in 1995.

Source: OECD Economic Outlook, No. 80; OECD, *National Accounts of OECD Countries*, 2006.

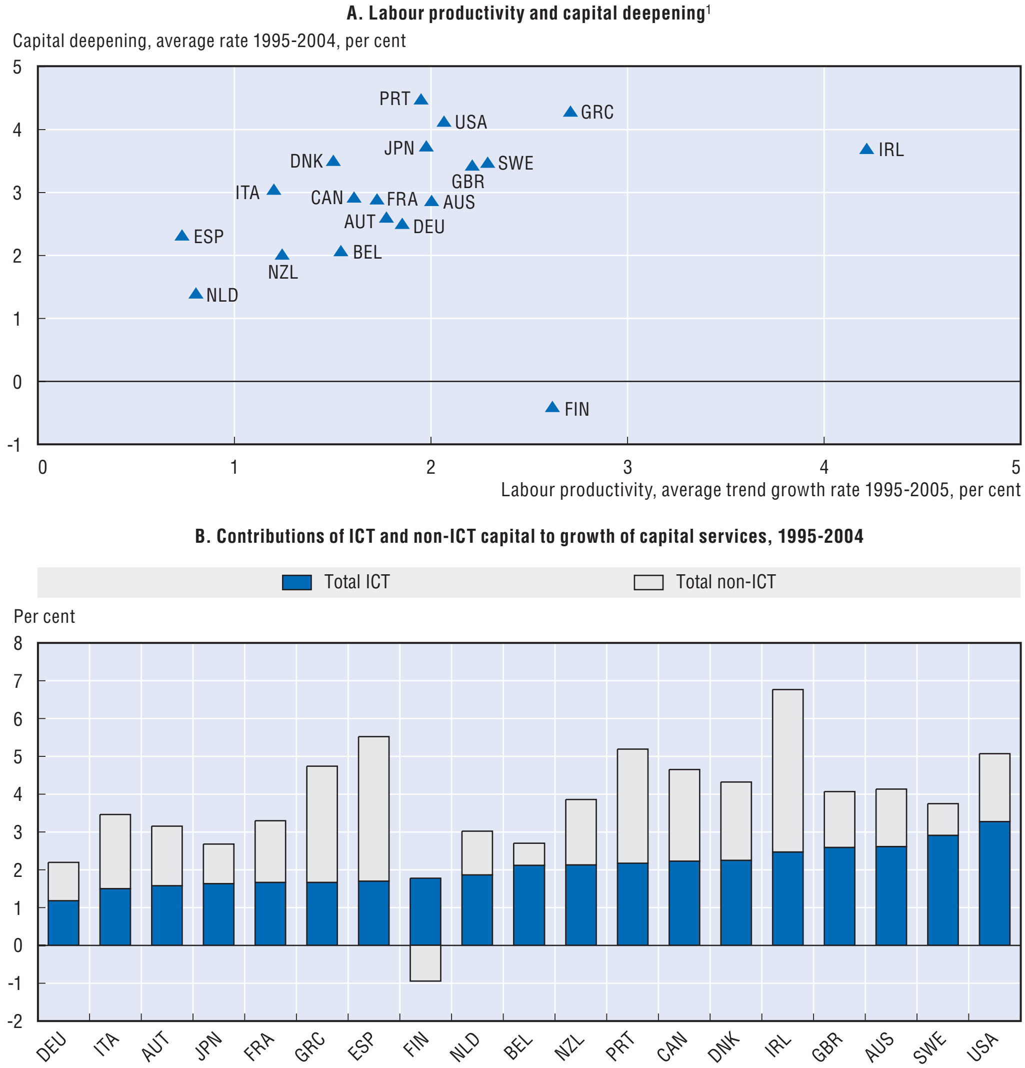
StatLink: *http://dx.doi.org/10.1787/883760240084*

The persistent weakness of labour productivity in the Netherlands and Spain over the past ten years may to some extent reflect progress in raising labour utilisation by increasing the employment of less productive workers. This would tend to depress the measured average labour productivity growth and further distort the picture of true underlying productive capacity.

One reason for the failure of most countries to narrow the productivity gap is that the increase in capital deepening, *i.e.* capital services per hour worked, in the United States has been faster than in almost all other countries for which data are available (Figure 1.A1.2). This

* For example, even with the fifth highest rate of trend labour productivity growth in the OECD over the past ten years, Hungary would still take over a decade to reach half of the level of labour productivity in the United States.

Figure 1.A1.2. **The contribution of investment in physical capital**



1. Labour productivity is defined as in Figure 1.A1.1. Capital deepening is measured as the growth rate of capital services less the growth rate of total hours worked.

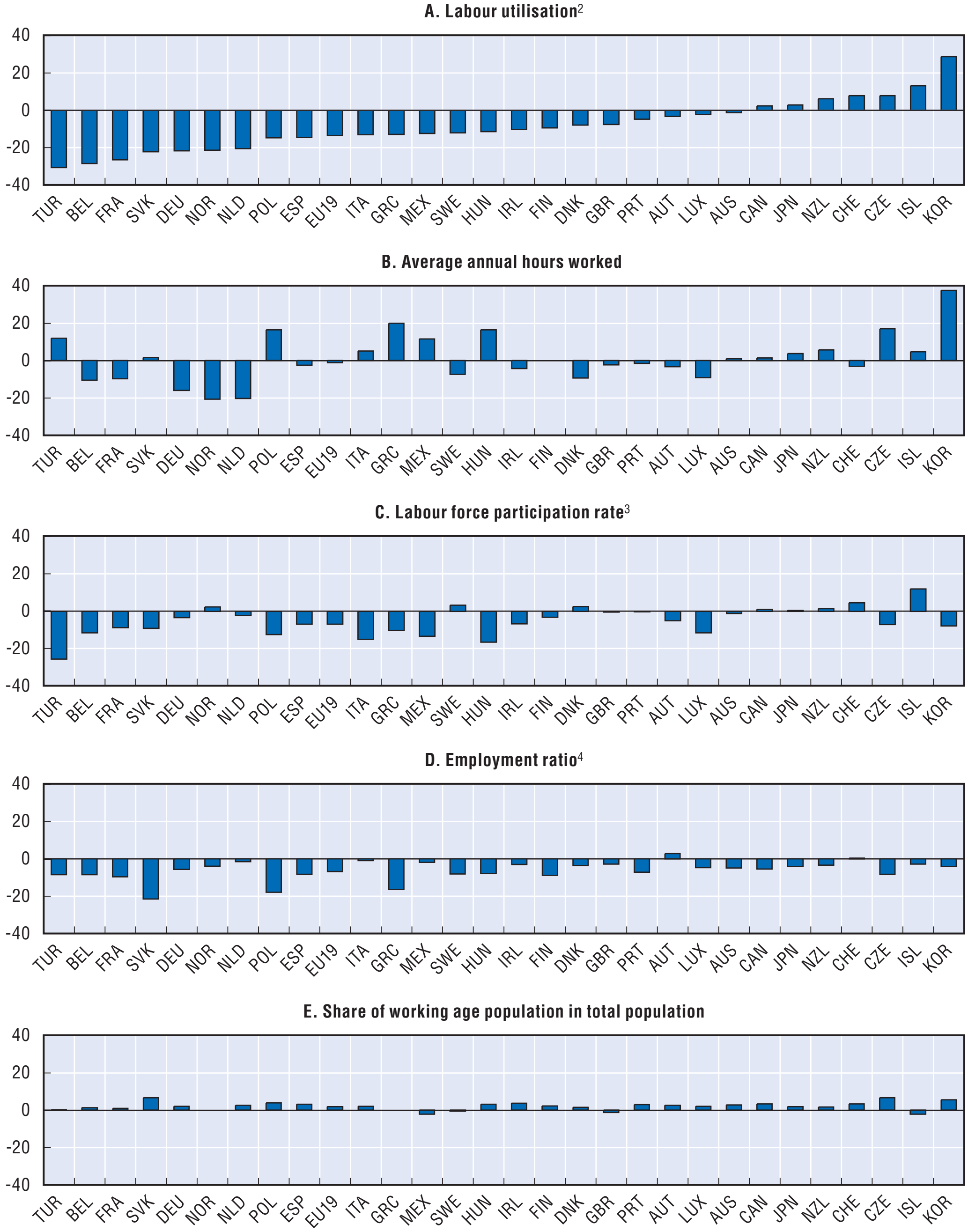
Source: OECD, Productivity database; OECD, *National Accounts of OECD Countries*, 2006; and *OECD Economic Outlook*, No. 80.

StatLink: *http://dx.doi.org/10.1787/773803620204*

strong performance has been associated with particularly strong investment in ICT equipment. Growth of capital services has typically been weaker in countries, such as in Continental Europe, where the contribution from ICT capital services has been less. Non-US English-speaking countries have experienced strong contributions to growth from ICT capital services but less than in the United States. For many countries, this weaker capital-deepening relative to the United States accounts for their relative weakness in labour productivity growth. In other countries (Canada, Denmark, Italy, Netherlands, New Zealand, Spain and Switzerland), the relatively weak productivity growth performance is largely accounted for by substantially weaker growth in trend multi-factor productivity than in the United States. By contrast, trend multi-factor productivity has contributed substantially to the convergence of labour productivity for a small number of countries, such as Finland, Iceland, Ireland and Norway.

Figure 1.A1.3. **The sources of labour resource utilisation differences, 2005**[1]

Percentage gap *vis-à-vis* the United States



1. Countries are ranked on the basis of their labour utilisation. 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.
2. Total hours worked during the year as a ratio of total population.
3. Population in the labour force as a ratio of working-age population.
4. Total employment as a ratio of the labour force. Employment is measured on a national accounts basis. For most countries, the difference with a measure based on labour force surveys is minor. One important exception is the United States where employment based on national accounts is significantly higher.

Source: OECD, Labour Force Statistics database and OECD, Productivity database.

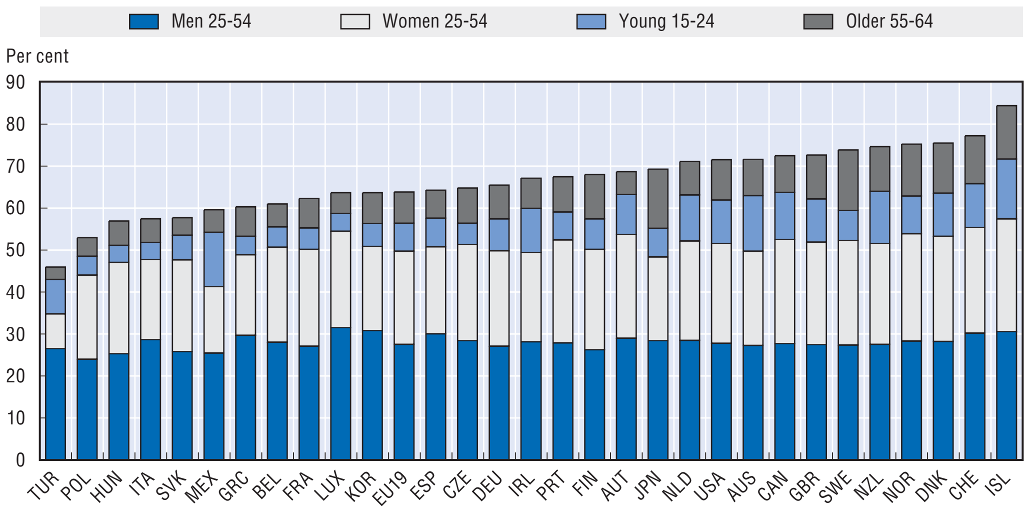
StatLink: *http://dx.doi.org/10.1787/468604030571*

Labour utilisation

In major Continental European countries the labour-utilisation gap, *i.e.* the smaller number of hours worked per person relative to the benchmark, is mostly explained by a combination of low average hours per person employed and low labour force participation (Figure 1.A1.3). Lower labour utilisation in Nordic countries is largely the result of low average hours worked per person employed as participation rates are typically relatively high. By contrast, the gap in lower-income countries, such as Hungary, Mexico, Poland and Turkey, is explained by low labour-force participation as average hours worked per employed person are high. High unemployment has a substantial negative effect on the labour-utilisation gap in Poland and Slovakia.

The weak employment rates of some countries are largely explained by low employment of some specific groups, such as of younger workers, women and those aged 55 and over; the contribution of prime-aged males to employment is very similar across countries (Figure 1.A1.4). Female employment is relatively limited in lower-income, Asian and Mediterranean OECD countries. Employment of young and older workers is weak in some lower-income and Continental European countries. In addition to explaining much of the difference between countries, changes in employment for these groups also account for a large part of the increase in the overall employment rate. For example, overall employment rates have increased over the past ten years in Finland, Hungary, Netherlands and New Zealand due in part to an expansion of employment of older workers.

Figure 1.A1.4. **Contribution of specific age/gender groups to overall employment rates, 2005**



1. Prime-aged workers defined as aged 25-54, older workers defined as aged 55 to 64.

Source: OECD, Labour Force Statistics database.

StatLink: *http://dx.doi.org/10.1787/127530562638*

Overall, progress in raising labour resource utilisation has been mixed over recent years. While the labour market performance in the United States improved relatively strongly in the late 1990s, the trend employment rate and average hours per worker have both declined since 2000. Elsewhere, trend labour utilisation has increased over the past ten years in a few countries where it has been traditionally low, such as Ireland, Netherlands and Spain. It has also risen in many countries with already good performance, such as Canada and New Zealand. By contrast, trend labour utilisation has fallen further from an already low level in France and Turkey. Higher participation rates have tended to raise labour utilisation in most countries over the past ten years, helped by the modest fall in unemployment in many OECD countries. This increase in the proportion of people working has typically been at least partly offset by shorter average hours per person employed, which reflects to some extent the increased incidence of part-time work.

ANNEX 1.A2

Selection of Policy Priorities

This annex describes the process of selecting the policy priorities listed in Table 1.1 and discussed in detail in the country notes in Chapter 2. The five priorities are chosen on the basis of indicators and OECD expertise. The selection of priorities proceeds in two steps:

- Step one – identification of weaknesses in performance at an aggregate and/or at a disaggregated level based on international benchmarking.
- Step two – identification of potential policy priorities when poor performance is associated with policy settings that are weak by cross-country comparison.

Each step is discussed below under a separate heading.

Identification of performance weaknesses

The top-level indicator of performance is the comparative level and growth rate of GDP per capita *vis-à-vis* the United States. This country is chosen as the numeraire to assess relative performance because it has historically been among the leading OECD countries in terms of material living standards.

For priority selection, the gap in GDP per capita is broken down into its main sub-components: labour resource utilisation and productivity. A breakdown into sub-components allows for a finer assessment of performance and for the possibility to detect areas of weakness even in countries that are leading in terms of overall GDP per capita.

The labour-productivity gap, *i.e.* the difference with the numeraire country in terms of output per hour worked, can be further broken down into capital services available per hour worked and multi-factor productivity.

Likewise, the labour-utilisation gap, measuring the difference in average hours worked per person *vis-à-vis* the numeraire country, can be further decomposed into three factors: the average number of hours worked per employee, total employment as a ratio of working age population, and the share of the working-age population in the total population.

The aggregate employment rate is supplemented as a measure of performance by group-specific employment rates that more precisely identify where the weakness in performance lies. Many of the differences in overall employment rates across countries and the changes in employment can be explained by specific groups, such as the young, women and older workers.

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Identification of policy priorities

Five policy priorities are then established for each country, addressing areas where performance weaknesses have been identified. Three of the priorities are selected on the basis of cross-country comparison of indicators of the stance of policies, confirmed by judgement and experience of country experts. The remaining two priorities primarily draw on country expertise, although they are often also supported by indicators. This allows some scope to select policy priorities in areas not covered by the set of indicators.

Selection of indicator-based priorities

Indicator-based priorities are set by comparing policies across OECD countries.

The comparisons are based on a set of around 50 policy indicators (see Chapter 3). These cover a broad range of policy areas, such as labour market policies, education, product market regulation and health. The construction of these indicators draws on the expertise of a number of OECD directorates:

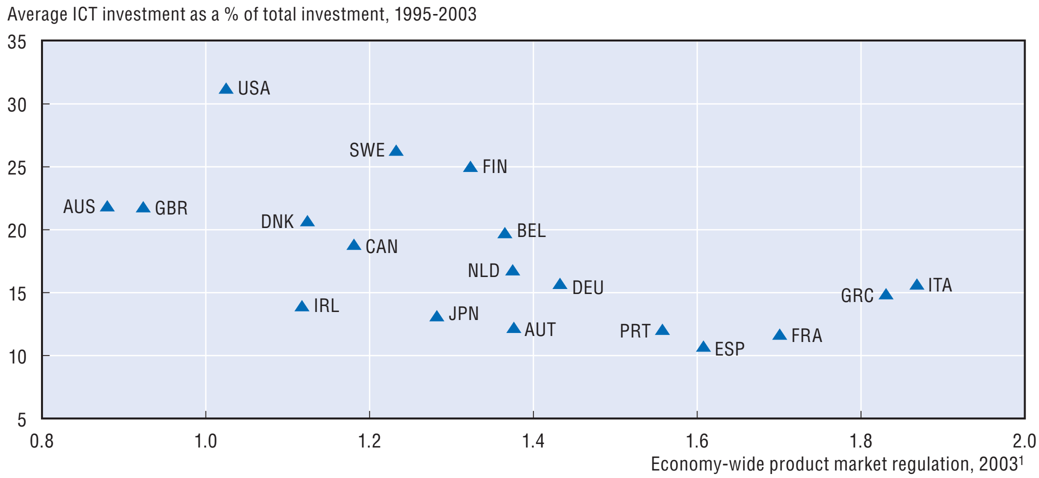
- Labour market and social policy indicators are monitored on a regular basis and the results reported in the *OECD Employment Outlook* and *Benefits and Wages*, as well as in other reports such as *Pensions at a Glance*.
- The extent and quality of education of the young and the wider populations are reviewed regularly and published in *Education at a Glance*, reports from the Programme for International Student Assessment (PISA), and country reviews.
- Developments in the taxation of labour income and standardised indicators of taxation are published in *Taxing Wages*.
- *Agricultural Policies in OECD Countries* monitors support to agriculture.
- Performance and policies in the area of science, technology and industry are reviewed in *Science, Technology and Industry: Outlook*; the *Information Technology Outlook*, the *OECD Communications Outlook*, and the *SME and Entrepreneurship Outlook*.
- Policies that affect regulation, competition and market openness are reviewed regularly and published in the series of *OECD Reviews of Regulatory Reforms*.

New indicators have been incorporated into the selection of indicator-based priorities for this edition of *Going for Growth*. These include indicators of innovation policies drawn from the analysis presented in *Going for Growth 2006*.

Indicators are intended to provide a quantitative summary of the stance of policy in a particular area. As such, they do not necessarily fully capture all the dimensions of a policy setting, nor the way in which policies are enforced in each country. Constructing indicators is a resource-intensive process and so it is not always possible to update them at a high frequency. As a result, indicators do not necessarily reflect all the recent developments in policy and some reforms will not be captured if they fall outside the dimensions considered in the indicator. Given these difficulties, it is essential to apply judgment and expertise in using indicators to set policy priorities. In this regard, matching policy priorities to weaknesses in performance helps to mitigate the risk of employing potentially misleading indicators by requiring that an indicator reading showing a poor policy should be matched by a weak performance in an area affected by the policy in question.

The matching of specific performance and policy areas is based on economic analysis of the impact of policies, supported by empirical evidence. Although multi-variate econometric analysis is usually necessary to establish a robust relationship between two variables, the link between policy settings and economic performance can be shown with a simple bi-variate example. As explained in detail in Chapter 5, economy-wide product market regulation (PMR) can limit competition. This reduces the incentive for firms to invest in ICT equipment and slows the process by which new technologies are adopted. Indeed, there is a clear negative relationship between PMR and the share of ICT investment in GDP as strict regulations reduce investment in ICT (Figure 1.A2.1). Using this particular match of performance and policy, a relatively low share of ICT in total investment and, at the same time, relatively stringent regulatory barriers to competition, would point to an easing of product market regulation as a candidate for a policy priority for the country in question.

Figure 1.A2.1. **Relating policy to performance: product market regulation and ICT investment**



1. The scale of the indicators is 0-6 from least to most restrictive.

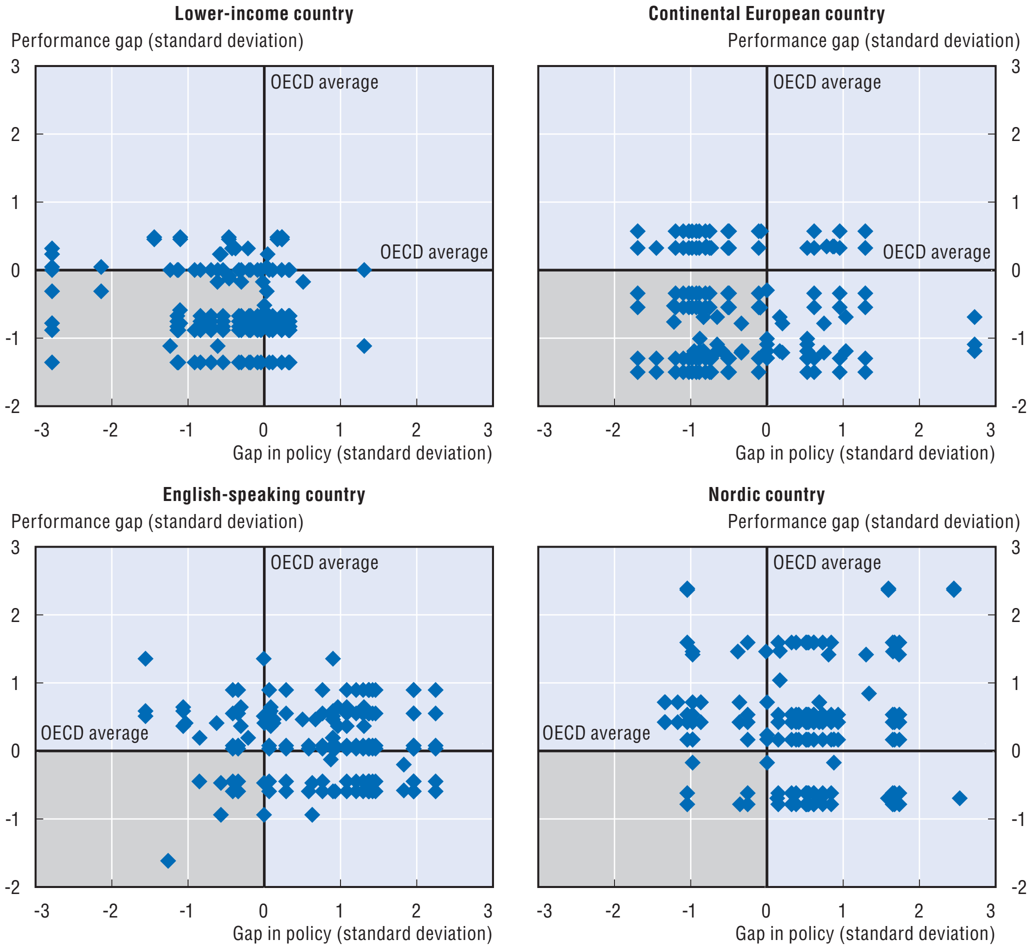
Source: OECD, Product Market Regulation and Productivity databases.

StatLink: *http://dx.doi.org/10.1787/852854601456*

The identification of policy priorities for each country based on matching poor policy settings and weak performance can be further illustrated using examples from different types of economies. In Figure 1.A2.2, indicators of performance and policy settings are re-scaled so that each has a mean of zero and a standard deviation of one, and positive numbers indicate a position better than OECD average. Given that several policies may affect one measure of performance and that a single policy may affect performance in a number of ways, there is a large number of policy-performance matches to consider as priority candidates. In this framework, a policy setting is considered as a candidate for a priority if a sub-par performance in a specific area (*e.g.* ICT investment) is matched with an inadequate related policy setting (*e.g.* product market regulation), with the respective OECD averages used as benchmark.

Therefore, performance-policy matches falling in the lower-left quadrant of each panel of Figure 1.A2.2 indicate policy settings that could be considered as candidates for a priority. For instance, a *lower-income* country typically has a large number of policy priority candidates, as the below-average level of income often reflects poor policy settings that lead to weak performance in key determinants of growth, such as labour productivity. By contrast, it is generally more difficult to identify candidates for policy priorities in *English-speaking* countries as these tend to have policy settings more favourable than the OECD average and also relatively strong performance.

Figure 1.A2.2. **Examples of selection of candidates for policy priorities: matches of performance and policy indicators**[1]



1. Performance and policy gaps relative to OECD average, where positive numbers indicate position better than average. The bottom-left quadrant represents candidates for policy priorities. Indicators rescaled to have mean of zero and standard deviation of one across countries.

StatLink: *http://dx.doi.org/10.1787/000351062521*

Continental European countries typically have policy settings that are somewhat less supportive of growth and employment than the OECD average so that, despite their above average level of income, there are still many candidates for policy priorities in these economies. *Nordic countries* show a number of policy settings that would generally be considered weaker than the OECD average but that are not selected because there is no corresponding relative weakness in performance, due to other policies and features of the economy.

Given the potentially large number of candidates for priorities in many countries, other information and criteria are then applied to identify the most pressing indicator-based policy priorities. For instance, the difference between the policy indicator and the OECD average can be taken as an indication of how far a policy setting is from good practice and how this compares with other policies. In general, policies furthest away from the benchmark are most likely to indicate a policy priority. Econometric estimates of the impact on performance of changing policy provide additional guidance in selecting the policies that would be likely to have the greatest impact on performance if they were raised to the OECD average. Finally, recent trends in policy and performance are further taken into account to determine policy priorities. For example, the increase in sickness and disability recipients over recent years is a matter of concern even if this is not always associated with a clear performance weakness in the countries where it has become a pressing issue.

Other key priorities

There will inevitably remain important policy areas that cannot be assessed on the basis of a quantitative indicator, even as the set of indicators expands. Two additional priorities are thus selected for each country, mostly drawing on the detailed expertise from OECD working committees and country experts. These will normally be issues that have also been addressed in the *Economic Survey* of the country concerned. In many cases, these priorities will also be supported by a policy indicator but in cases where they are not, judgment is used to determine the impact on a specific area of economic performance.

Implications and revisions to priorities

Setting an equal number of policy priorities for all countries is motivated by the desire to identify reforms that improve performance in all countries, the better-performing economies included. For countries with pressing performance problems and weak policy settings, this ensures that only the most important policies are retained and that a manageable agenda is identified, even if some important policy recommendations will be left out. For the best-performing countries, where areas of absolute weaknesses may be more difficult to identify, the policy priorities may appear less pressing.

Naturally, some of the five policy priorities differ from those identified in the 2005 issue of *Going for Growth*. On average, between one and two priorities have changed per country since the previous publication. This reflects policy reforms and improvements in performance that make a particular issue less of a priority relative to others, even if reform is sometimes incomplete or does not necessarily fully address the weak performance. Expansion of the set of indicators and new analysis have also resulted in the introduction of new priorities, in innovation for example, that have replaced an earlier policy priority even where there has been no policy action.

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Going for Growth

PART I

Chapter 2

Country Notes

This chapter provides more detailed information on key policy priorities for individual OECD member countries and for the European Union.

AUSTRALIA

Growth has been strong and stable, but the income gap with the best performing countries remains substantial because of a large productivity shortfall. Employment rates for the low-skilled and older workers are still relatively low, notwithstanding recent improvements.

Priorities supported by indicators

Reform disability benefit schemes

The sharp rise in the number of people, especially older workers, receiving the Disability Support Pension (DSP) halted in 2004, but the continuing high level contributes to the relatively low employment rate for persons aged 55 and over.

Actions taken: The 2005/06 Budget increased work obligations and tightened eligibility for new claimants of DSP; those capable of working 15 hours or more per week will receive unemployment benefits instead of disability benefits, entailing increased obligations to look for work.

Recommendations: Extend the job-capacity assessment and associated support services more systematically to those who started receiving DSP before July 2006, with eligibility being based only on medical criteria, removing the additional consideration of employment prospects for those aged over 55.

Improve upper-secondary education attainments

The high share of the low-skilled in unemployment and inactivity, especially early school-leavers, suggests that the upper-secondary education system's emphasis on preparation for university is too narrow.

Actions taken: A range of recent government initiatives aims at increasing the labour market responsiveness and flexibility of the vocational education and training (VET) system. Included in this are new programmes targeting existing workers with low qualifications to improve their basic skills so they can attain VET or year 12 (final school year) qualifications.

Recommendations: Promote enrolment in the VET system, as well as address the high level of non-completion of such courses, by raising their quality and providing additional support for disadvantaged groups, such as those with minimal previous educational attainment or from low-income families.

Strengthen competition in network industries

Although overall product market regulation is among the least restraining of competition in the OECD, there is scope to raise nation-wide competition and efficiency in the provision of water, transport, electricity and telecommunications.

Actions taken: An agreement between the federal and state governments in 2006 aims to implement a consistent national system of economic regulation for infrastructure services of national significance. The National Water Initiative in 2004 aims to establish a nation-wide market-based system of managing water resources.

Recommendations: Establish nationally uniform regulations for the interstate rail network as a prelude to achieving greater competitive neutrality in rail and road transportation. In the electricity sector, lift remaining retail price regulations for households and privatise state-owned generation to strengthen competition in that segment. Remove remaining regulatory constraints on trading water so that water moves to higher value uses.

Other key priorities

- Lower the impact of low-wage traps for low-income earners, thus encouraging them to move from part-time to full-time work, by reducing the lower rates of income tax and raising personal allowances or by reducing withdrawal rates for means-tested family benefits.
- In order to increase flexibility of wage bargaining and determination, phase out or rationalise the system of "award wages", which still sets complex wage floors in significant parts of the labour market.

AUSTRALIA

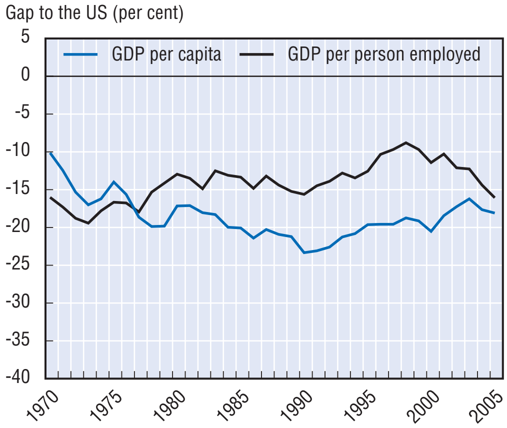
Structural indicators

Average annual trend growth rates, per cent

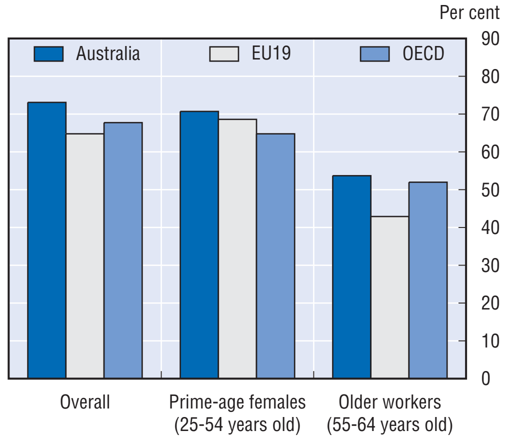
	1995-2005	1995-2000	2000-05
GDP per capita	2.3	2.4	2.2
Labour utilisation	0.3	0.4	0.2
of which: Employment rate	0.6	0.6	0.5
Average hours	–0.3	–0.2	–0.3
Labour productivity	2.0	2.0	2.0
of which: Capital intensity	0.8	0.7	0.9
Multifactor productivity	1.2	1.2	1.1

Source: Estimates based on *OECD Economic Outlook*, No. 80.

A. Gaps in GDP per capita and productivity remain substantial[1]

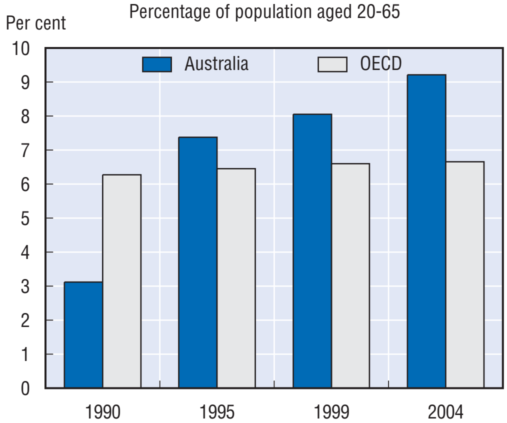


B. Employment rates are high, 2005



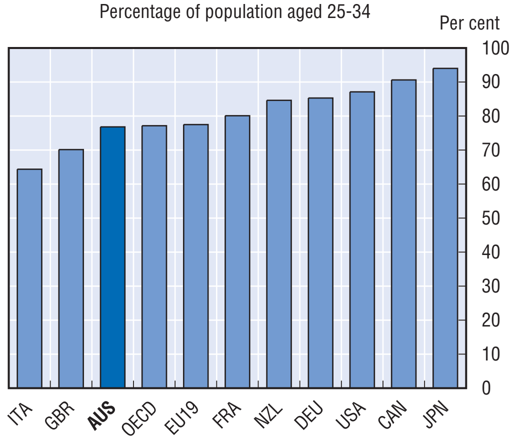
C. The share of working-age population receiving disability benefit has risen steadily

Percentage of population aged 20-65



D. Upper-secondary education attainment is only at OECD average, 2004

Percentage of population aged 25-34



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, *Transforming Disability into Ability*, 2003 and OECD calculations; Chart D: OECD, *Education at a Glance*, 2006.

StatLink: *http://dx.doi.org/10.1787/716436587346*

AUSTRIA

GDP per capita is high, but the gap vis-à-vis *the best performing countries is widening. The gap reflects relatively weak productivity performance and low employment rates of older workers.*

Priorities supported by indicators

Reduce barriers to entry in network industries

High network access prices and remaining state ownership in network industries deter new entrants, hindering greater competition and sustaining high prices.

Actions taken: Network access prices were reduced but remain high.

Recommendations: Facilitate new entrants' access to networks by reducing access prices and remaining cross-subsidies. Relax ownership restrictions that create high barriers to entry at various stages in the production and distribution of electricity. Achieve full privatisation in the telecommunications and electricity sectors.

Reduce implicit taxes on continued work at older ages

High implicit taxes on continued work at older ages encourage early retirement and reduce labour force participation.

Actions taken: The 2004 General Retirement Income Act built on earlier reforms, but also reinstated early retirement at 62 for those with at least 37.5 years of insurance contributions and introduced a new early retirement scheme for "heavy workers".

Recommendations: Move towards making old age pensions more actuarially neutral around the statutory retirement age. At a minimum, revise the "heavy workers" scheme to tighten entry conditions and ensure that it is effectively enforced at all levels of government. Proceed further to harmonise pension schemes throughout the public sector with the private sector. Eliminate higher unemployment benefits for older jobless workers, and phase out subsidies for part-time employment at older ages.

Improve graduation rates from tertiary education

The share of the labour force with tertiary education is low, and the quality of some vocational and tertiary education programmes remains sub-standard. This holds back productivity growth and innovation.

Actions taken: A university reform was introduced, linking part of public funding to performance indicators.

Recommendations: Further strengthen the performance-based funding system in tertiary education. Student fees should be raised, combined with the introduction of a loan scheme with income-contingent repayments.

Other key priorities

- Enhance work and enterprise incentives by lowering marginal income tax rates and by further broadening the tax base through reducing the numerous tax allowances.
- Restrictive regulations remain widespread in services, limiting competition and contributing to slow productivity growth. Both self-imposed and statutory regulation of trades and professions should be reduced. Compulsory chamber membership for the liberal professions should be abolished. Shop opening hours should be further liberalised.

AUSTRIA

Structural indicators

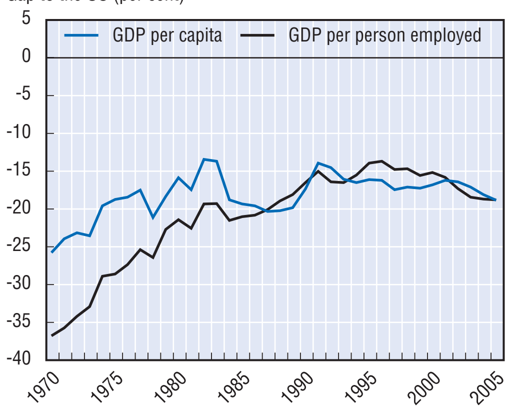
Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	2.0	2.2	1.9
Labour utilisation	0.3	0.2	0.3
of which: Employment rate	0.3	0.3	0.2
Average hours	0.0	–0.1	0.0
Labour productivity	1.8	1.9	1.6
of which: Capital intensity	0.6	0.7	0.4
Multifactor productivity	1.2	1.2	1.2

Source: Estimates based on *OECD Economic Outlook*, No. 80.

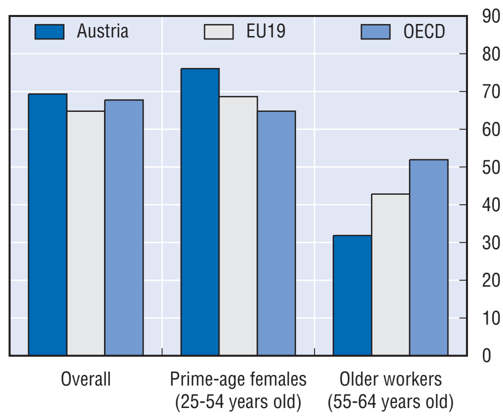
A. Convergence in GDP per capita and productivity has stalled[1]

Gap to the US (per cent)



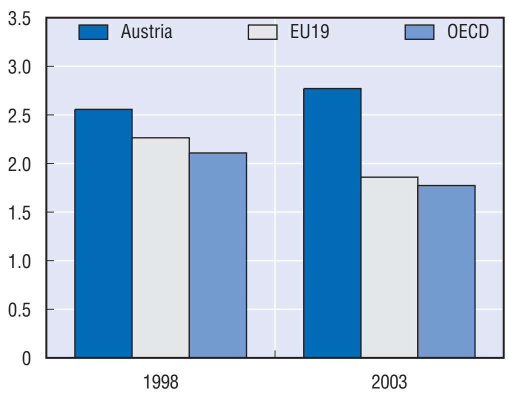
B. The employment rate of older workers is low, 2005

Per cent



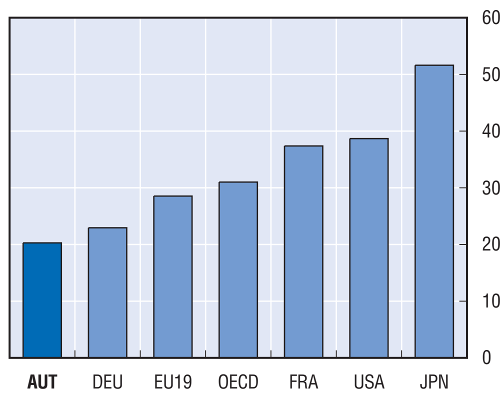
C. The administrative burden to set up a business is high[2]

Index



D. The share of population aged 25-34 with tertiary education is low, 2004

Per cent



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Indicator scale of 0-6 from least to most restrictive.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Product Market Regulation database; Chart D: OECD, *Education at a Glance*, 2006.

StatLink: *http://dx.doi.org/10.1787/716436587346*

BELGIUM

The gap in GDP per capita with the best performing countries remains substantial, largely owing to low employment rates of older workers and immigrants, as well as geographical mismatches in the labour market.

Priorities supported by indicators

Further reduce the implicit tax on continued work at older ages

High public subsidies to early retirement, including via unemployment insurance benefits for older workers and special early retirement pensions, contribute to very low employment rates for the older working-age population.

Actions taken: The general minimum age for entry into early retirement via the old-age pension system is being raised from 58 to 60 years and a number of paths to early retirement have been closed. The standard retirement age for women is being aligned with that of men (65 years). Social security charges for older workers have been lowered.

Recommendations: Continue to phase out alternative routes to early retirement by realigning access conditions to such schemes with those for standard old-age pensions. The possibility for accumulating pension rights for persons in special early retirement schemes should be removed and early receipt of old-age pensions should be made more actuarially neutral.

Further reduce the tax wedge on low-income workers

High effective taxes on labour income contribute to the low labour market participation rates among low-income workers and immigrants.

Actions taken: Additional reductions in social security charges and personal income taxes have been implemented.

Recommendations: Implement further targeted cuts in social security charges and personal income tax rates for low-income workers together with offsetting spending cuts.

Ease regulation in the retail sector

The regulation of the retail sector is stricter (particularly in terms of zoning and opening hours) than in most other OECD countries, notwithstanding recent reforms. This sector has a high capacity to create jobs for groups with low employment rates, by providing flexible work-time schedules and employment opportunities for the low-skilled.

Actions taken: Recently the threshold surface above which special regulations apply has been increased from 700 m^2 to 1 000 m^2 and restrictions on opening hours have been relaxed somewhat.

Recommendations: Continue relaxing regulation of zoning and shop opening hours.

Other key priorities

- Reduce large geographical mismatches in the labour market by allowing wage determination to reflect local labour market conditions through increasing the scope for individual companies to opt out from sector agreements.
- Strengthen enforcement of job-search requirements for the unemployed, redirect ALMP funds from subsidised employment to training and ensure better co-ordination between placement agencies in different regions to facilitate the return to employment.

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BELGIUM

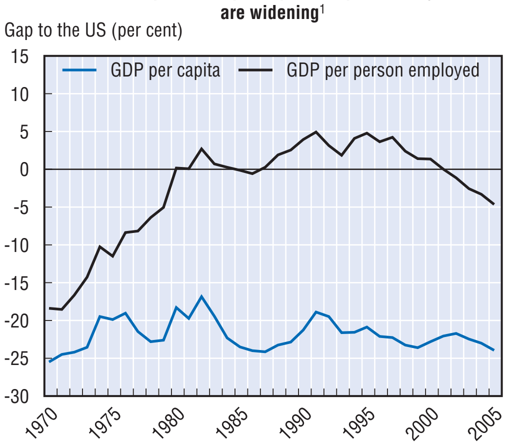
Structural indicators

Average annual trend growth rates, per cent

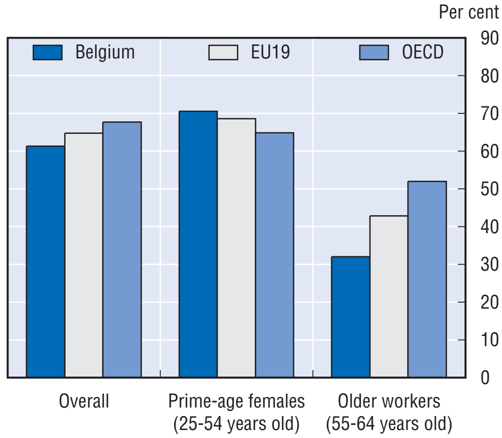
	1995-2005	1995-2000	2000-05
GDP per capita	1.8	2.0	1.7
Labour utilisation	0.3	0.3	0.3
of which: Employment rate	0.5	0.5	0.5
Average hours	–0.2	–0.2	–0.1
Labour productivity	1.5	1.7	1.4
of which: Capital intensity	0.6	0.7	0.4
Multifactor productivity	1.0	1.0	1.0

Source: Estimates based on *OECD Economic Outlook*, No. 80.

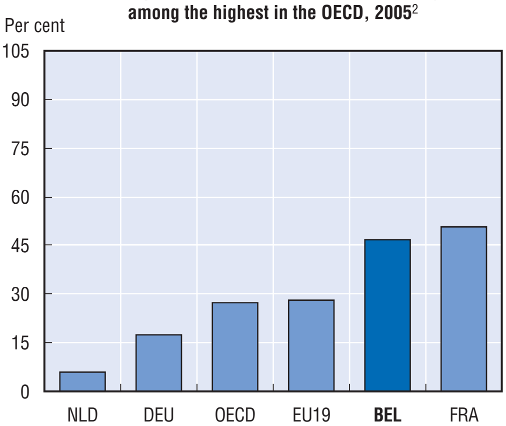
A. Gaps in GDP per capita and productivity are widening[1]



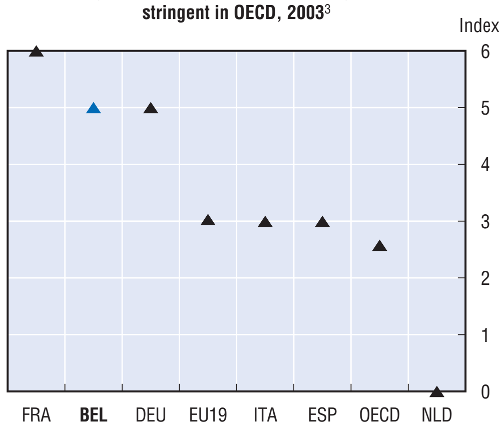
B. The employment rate of older workers is low, 2005



C. The implicit tax on continued work at older ages is among the highest in the OECD, 2005[2]



D. Regulation of large outlets is among the most stringent in OECD, 2003[3]



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Implicit tax on continued work embedded in the regular old-age pension scheme, for 60-year-olds.
3. Indicator scale of 0-6 from least to most restrictive.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; 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.

StatLink: *http://dx.doi.org/10.1787/716436587346*

CANADA

Despite buoyant employment in recent years, the GDP-per-capita gap vis-à-vis *the United States remains substantial, reflecting to a large extent lower productivity levels.*

Priorities supported by indicators

Further reduce barriers to competition in professional services

Around 50 professions and 100 trades are regulated in one or more provinces. This limits inter-provincial trade in services.

Actions taken: In April 2006, Alberta and British Columbia signed a comprehensive agreement to enhance trade in goods and services between the two provinces, providing mutual recognition of occupational certifications in both provinces. In September 2006, the federal government, all provinces and two territories agreed to achieve, by April 2009, compliance with the labour mobility provisions of the Agreement on Internal Trade for all existing regulated occupations.

Recommendations: Dismantle the remaining obstacles to inter-provincial trade and reduce the number of "regulated occupations".

Further reduce barriers to foreign ownership

Restrictions on foreign direct investment remain higher than in the majority of OECD countries, in particular in telecommunications, broadcasting and air transport. These hamper investment and slow the diffusion of new technology and management practices.

Actions taken: In late 2006, the government made a commitment to review its foreign investment policy framework, including the screening mechanism under the Investment Canada Act. Earlier in 2006, the Telecommunications Policy Review Panel recommended a phased liberalisation of foreign-ownership restrictions in that sector. Also, the 2005 "open-skies" agreement with the United States has been updated and expanded.

Recommendations: Further reduce barriers by eliminating ownership restrictions in telecommunications and transport and by allowing a majority of board members to be non-residents in sectors where this is currently not allowed.

Liberalise the electricity market

Electricity markets are exposed to only limited competition in most provinces, suppliers are often vertically integrated and public ownership is prevalent. Only two provinces have well-developed retail markets.

Actions taken: Modest progress has been made in some provinces. In October 2005, Ontario introduced peak-load pricing for residential consumers through the Regulated Price Plan.

Recommendations: Develop competitive retail markets in all provinces and allow markets to set prices. Increase integration across both provincial and North American electricity markets.

Other key priorities

- Reform the Employment Insurance system by introducing firm-level employer experience rating or by imposing longer waiting periods for benefit entitlement so as to reduce cross-subsidies between businesses that have favoured those engaged in temporary or seasonal activities.
- Further reform the tax system by abolishing remaining provincial taxes on firms' ownership of capital and by switching from provincial retail sales taxes to value-added taxes. The corporate tax base should also be broadened and the same effective tax rates be applied to all businesses, regardless of size or sector of activity. Such measures would complement the recent and announced future reductions in federal and provincial corporate tax rates and provide additional stimulus to business investment.

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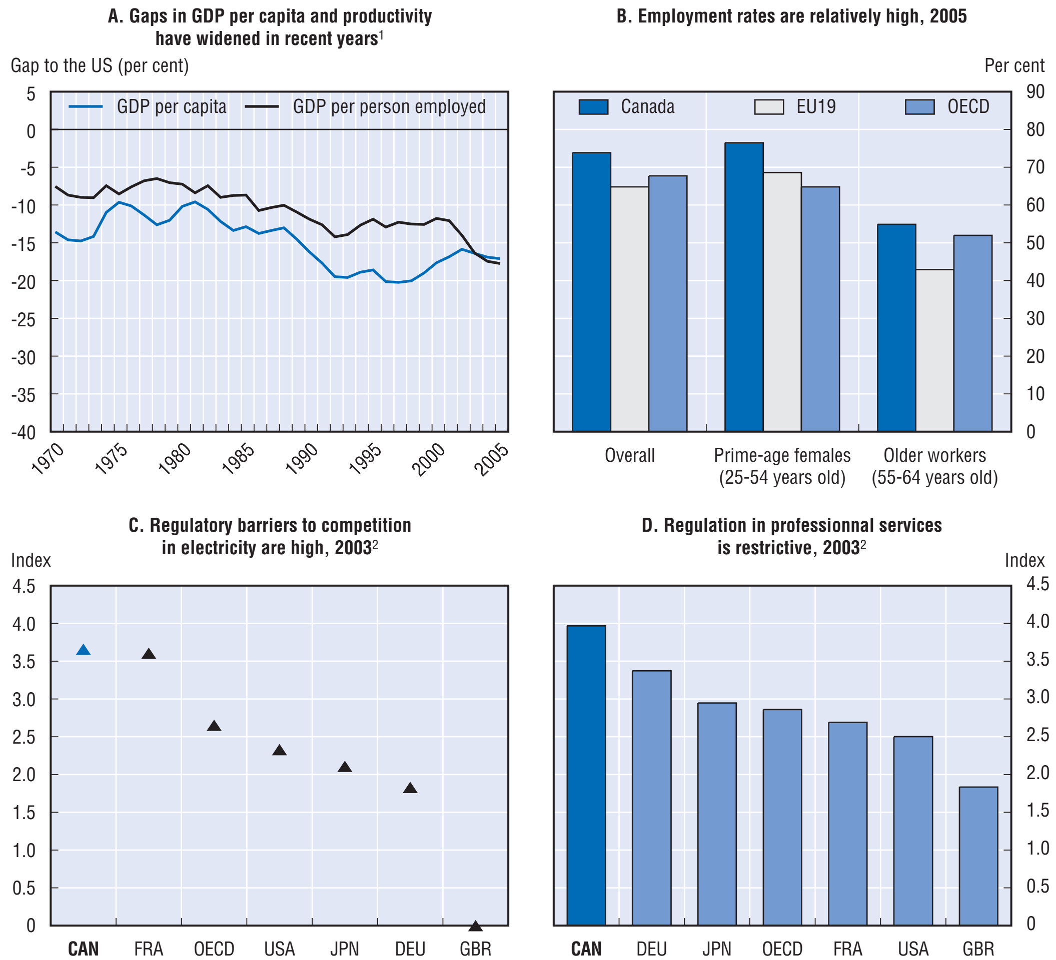
CANADA

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	2.1	2.2	2.0
Labour utilisation	0.5	0.5	0.4
of which: Employment rate	0.7	0.7	0.6
Average hours	–0.2	–0.1	–0.3
Labour productivity	1.6	1.6	1.6
of which: Capital intensity	0.9	1.0	0.9
Multifactor productivity	0.7	0.7	0.7

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Indicator scale of 0-6 from least to most restrictive.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Charts C and D: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/716436587346*

CZECH REPUBLIC

Strong labour productivity growth in recent years has supported the pace of catch-up, but both GDP-per-capita and labour-productivity gaps remain sizeable compared with the OECD average.

Priorities supported by indicators

Reduce the tax wedge for low-income workers

The high tax wedge on low earnings, which mainly comprises social contributions, boosts labour costs, thus hampering employment creation, and encourages evasion, notably through subcontracting with "self-employed" workers.

Actions taken: In January 2006, the tax wedge was cut by rate reductions and bracket widening in the two lowest levels of the tax schedule.

Recommendations: Aim to achieve further cuts in the tax wedge, in particular for low-income earners, financed by reducing public spending. Pension reform is also needed to help prevent future increases in contributions.

Reduce the costs of EPL for regular workers

Stringent employment protection is dampening labour turnover, thus contributing to high long-term unemployment in the labour market, with potentially adverse effects on productivity.

Actions taken: A new less constraining labour code was adopted in 2006.

Recommendations: Reduce notice period and severance pay requirements at short job tenures and lighten dismissal procedures to make termination of contracts simpler.

Reduce the administration burden for businesses

Legal procedures and administrative processes, such as business registration, have long been too cumbersome. This has had a particularly negative impact on the development of domestic businesses and has encouraged corruption.

Actions taken: Recent steps include amendments of the civil and commercial codes in 2005, which reduced the administrative workload for judges, standardised business registration forms, lightened checking procedures and shortened the maximum time allowed for the authorities to process files.

Recommendations: Further simplify business procedures to encourage entrepreneurship.

Other key priorities

- Intended reforms of the health care system need to be implemented as part of a general strategy to increase the efficiency of public spending. The sub-national levels of administration and government also need to raise efficiency, including by strengthening financial incentives for mergers at the municipality level and more financing flexibility.
- The education system needs to adjust to cope better with the increasing demand for tertiary-level education: elite streaming in secondary schooling should be scrapped and a fee system for tertiary courses introduced backed by income-contingent student loans.

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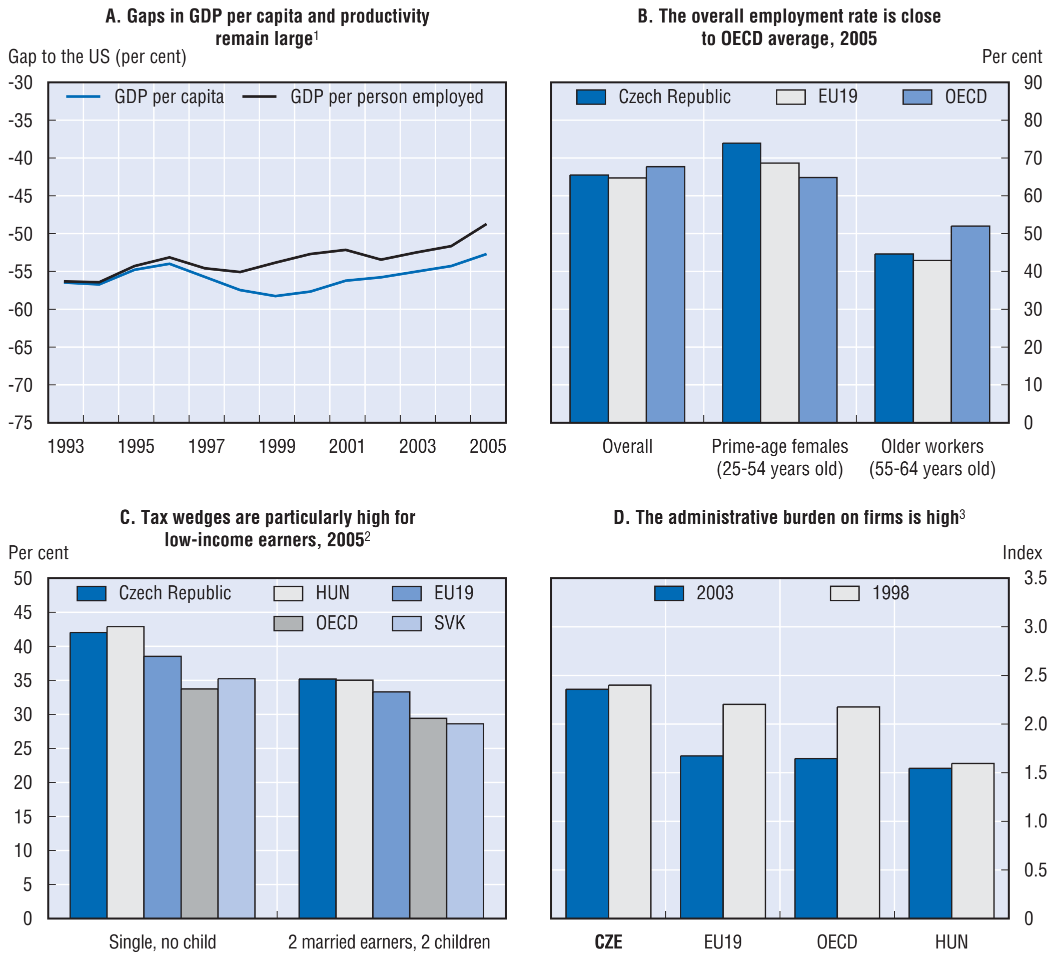
CZECH REPUBLIC

Structural indicators

Average annual trend growth rates, per cent

	1998-2005	1998-2000	2000-05
GDP per capita	3.7	3.1	4.0
Labour utilisation	–0.1	–0.1	–0.1
of which: Employment rate	0.4	0.3	0.4
Average hours	–0.5	–0.4	–0.5
Labour productivity	3.8	3.2	4.1
of which: Capital intensity	. .	. .	. .
Multifactor productivity	. .	. .	. .

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. With earnings equal to two-thirds of average earnings.
3. Indicator scale of 0-6 from least to most restrictive.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Taxing Wages database; Chart D: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/716436587346*

DENMARK

The level of GDP per capita is declining relative to the best performing countries, partly due to slower productivity improvements. Although employment rates are generally high, average working hours are relatively short, and labour utilisation is weak for some groups.

Priorities supported by indicators

Reduce marginal taxes on labour income

Marginal tax rates are high and the top bracket is applied from relatively low income levels. With social security contributions and income taxes combining to a marginal rate of above 60%, there is little incentive to work longer hours.

Actions taken: The tax freeze has ended the upward drift in municipal income tax rates, but the number of people in the top income tax bracket still grows.

Recommendations: When the cyclical position allows, lift the income threshold from where the top tax rate is applied. Raising the real-estate tax rate would create further room for cutting taxes on income from work and also help reduce indirect housing subsidies arising from the nominal freeze of real estate taxes.

Improve the efficiency of the education system

The proficiency of 15-year-olds in reading and science is relatively low while spending is among the highest in the OECD. Taxes and grants encourage university students to start and end studies late.

Actions taken: The introduction of national tests in reading, mathematics, science and English will monitor progress in schools, and teacher training will be strengthened in key subjects. Students applying for university places at most two years after ending their secondary education will be given priority. University funding and study programmes will be adjusted to encourage early completion.

Recommendations: Increase the educational content of the introductory year for six-year-olds to strengthen learning capacity and abolish the voluntary 10th form. Develop a system of tuition charging and loans for tertiary education to encourage completion, while reducing some high marginal income tax rates.

Reform disability benefit schemes

Although it has started to decline, the share of disability pensioners in the adult population is above the OECD average. Schemes giving wage subsidies and support to keep disabled people with significant remaining work capacity in employment suffer from overuse.

Actions taken: The maximum wage subsidy under the Flexjob scheme was reduced from July 2006, but it is still well above the disability pension. Flexjob eligibility assessment has also been tightened. Measures to better accommodate people with mental health problems in the workplace are being introduced.

Recommendations: Reduce the maximum Flexjob subsidy further and limit it to the actual hours worked, while paying unemployment benefits for the hours not worked. Review disability pensions and Flexjob cases on a regular basis with a view to bringing more beneficiaries back to unsubsidised employment. Develop prevention and rehabilitation further to facilitate an additional reduction of the number of disability recipients.

Other key priorities

- Notwithstanding relatively competition-friendly regulations in the business sector, restrictions in some sectors persist and should be eased. Open publicly-funded services to competition, continue privatisation, and broaden access to permits via one-stop shops. Streamline the competition agencies and remove interest group representatives from their boards.
- Reform housing policies. Free up resources by reducing housing subsidies and raise the real estate tax rate to be more neutral *vis-à-vis* other capital taxation. Abolish rent regulation and stop subsidisation of the rental sector.

DENMARK

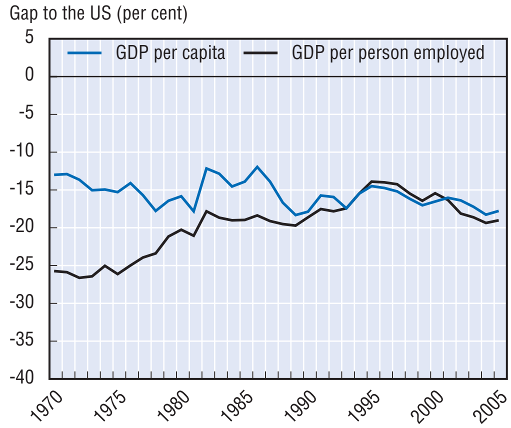
Structural indicators

Average annual trend growth rates, per cent

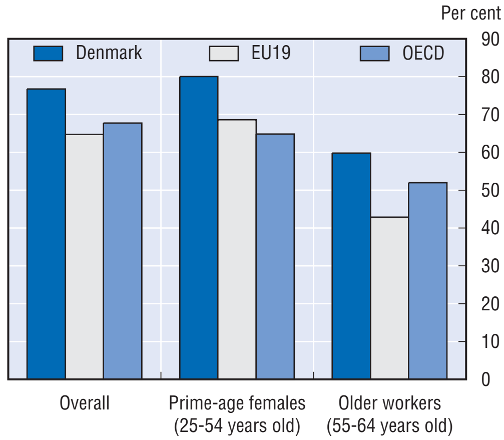
	1995-2005	1995-2000	2000-05
GDP per capita	1.8	2.1	1.4
Labour utilisation	0.3	0.6	0.0
of which: Employment rate	0.0	0.2	–0.3
Average hours	0.3	0.4	0.2
Labour productivity	1.5	1.5	1.5
of which: Capital intensity	1.0	0.9	1.1
Multifactor productivity	0.5	0.6	0.4

Source: Estimates based on *OECD Economic Outlook*, No. 80.

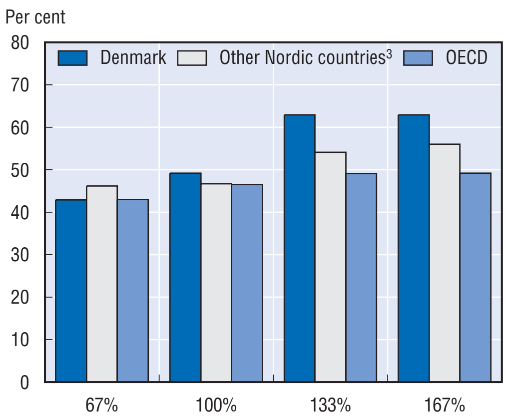
A. Convergence in GDP per capita and productivity has stalled[1]



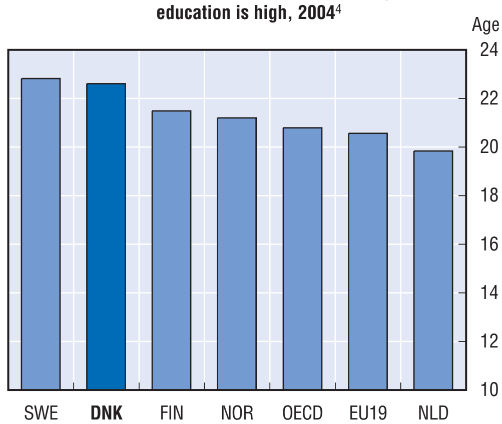
B. Employment rates are high, 2005



C. Marginal tax wedges are high, 2005[2]



D. The median age of entering tertiary education is high, 2004[4]



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Evaluated at 67%, 100%, 133% and 167% of average earnings.
3. Average of Finland, Iceland, Norway and Sweden.
4. Entry rate for tertiary-type A education.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Taxing Wages database; Chart D: OECD, *Education at a Glance*, 2006.

StatLink: *http://dx.doi.org/10.1787/716436587346*

EUROPEAN UNION

The income gap vis-à-vis *the United States has widened since the mid-1990s because of subdued growth in productivity and labour utilisation, in particular in the larger continental countries.*

Priorities supported by indicators

Ease the regulatory burden on business operations

Substantial barriers to internal trade remain in service sectors, including impediments to cross-border establishment and insufficient mutual recognition for business licences and professional qualifications.

Actions taken: The Services Directive was passed in Spring 2006, albeit in a form that falls short of the original proposal. This eases registration requirements for businesses operating in another country, but the key proposal – the country-of-origin principle – was rejected. Many service industries were exempted from the legislation.

Recommendations: Continue to reduce obstacles to internal trade, based on the principles enshrined in the Treaty of Rome. Adopt EU-wide standards where mutual recognition is difficult. Improve the EU public procurement regime.

Raise competition in network industries

Competition is patchy in network industries, with incumbents retaining considerable market power in some sectors. Liberalisation at the EU level is not always matched by rigorous implementation at the national level.

Actions taken: Regulatory frameworks are adapting, being toughened where the incumbent retains control and being liberalised where effective competition is emerging. The Commission has increased its capacity for economic analysis of competition cases.

Recommendations: Focus EU competition policy on reaping the potential gains from liberalising network industries. Ensure that attempts by member states to establish or maintain national champions do not compromise competition. Further liberalise the ports and the postal sectors, and create an EU-wide energy market. Push for quicker implementation of directives in the telecommunications and energy industries.

Reduce producer support to agriculture

Agricultural support under the Common Agricultural Policy (CAP) is distorting, keeping resources in low-productivity activities while disproportionately benefiting large and efficient farms. Support amounts to almost a third of farm receipts, double the US level.

Actions taken: The 2003 CAP reform decreased the proportion of support that is tied to production, and cut the intervention price of skimmed milk and butter. A reduction in support to the sugar industry is being phased in. The 2005 EU Budget deal saw a small increase in funding for the CAP.

Recommendations: Improve market access for non-EU countries. Continue to reduce production-linked support.

Other key priorities

- Raise labour mobility within the EU by improving the portability of occupational pension and social welfare benefit rights.
- Fully implement the Financial Services Action Plan to improve financial market integration. Accelerate efforts to integrate retail financial markets, especially mortgage lending.

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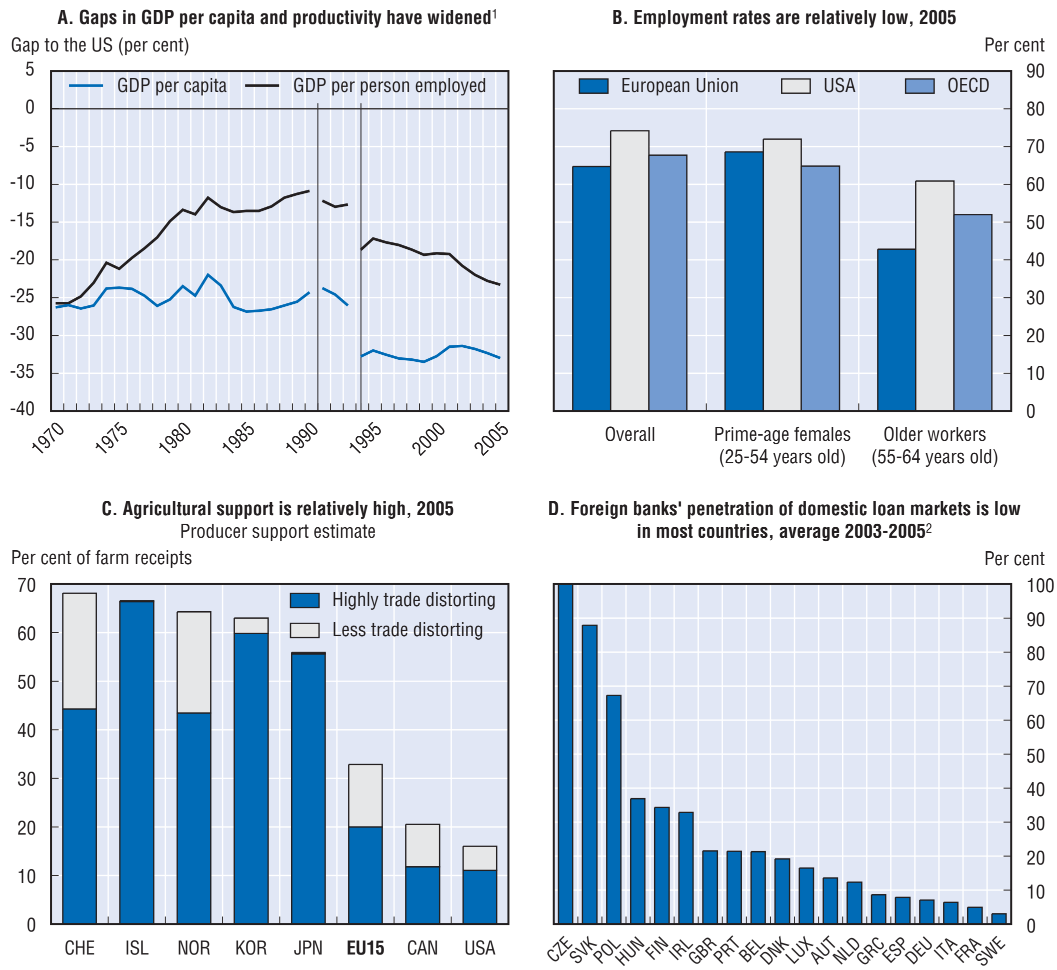
EUROPEAN UNION

Structural indicators

Average annual trend growth rates, per cent

	1995-2005[1]	1995-2000[1]	2000-05
GDP per capita	1.9	2.0	1.9
Labour utilisation	0.1	0.2	0.1
of which: Employment rate	0.5	0.6	0.5
Average hours	–0.4	–0.4	–0.4
Labour productivity	1.8	1.8	1.8
of which: Capital intensity	. .	. .	. .
Multifactor productivity	. .	. .	. .

1. Excluding Poland.
Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs). Break in the series in 1991 due to reunification of Germany and in 1994 when data start to refer to EU19.
2. Local claims in local currency only, measured as a percentage of all commercial banks' local claims on non-bank sectors (*i.e.* household, non-bank corporations and public sectors).

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Producer and Consumer Support Estimates database; Chart D: BIS and IMF.

StatLink: *http://dx.doi.org/10.1787/532416353370*

FINLAND

Driven by the ICT sector, convergence in GDP per capita vis-à-vis *best performing countries has been sustained. However, structural unemployment remains high and employment among older and low-skilled workers is relatively low.*

Priorities supported by indicators

Reduce the tax wedge on labour income

Average and marginal tax wedges on labour income are among the highest in the OECD. In combination with the compressed wage structure, this discourages employment, especially of the low-skilled.

Actions taken: Taxes on labour income have been reduced in line with the government's intention to cut taxes on earned income by almost 2% of GDP over the period 2004-07, but the tax burden remains relatively high.

Recommendations: Continue to reduce taxes on labour income and ensure fiscal sustainability by shifting the tax burden towards less distortionary taxation, such as property taxes.

Phase out early retirement pathways

Implicit taxes on continued work at older ages are high so that the expected number of years in employment for a 50-year-old male was only 9 years in 2005, well below the average of the other Nordic countries.

Actions taken: A wide-ranging pension reform was introduced in 2005 with the objective of extending working lives by 2-3 years by improving financial incentives to continue to work and restricting some early retirement pathways.

Recommendations: Make workers over the age of 59 subject to the same activation requirements as younger workers in order to qualify for on-going unemployment allowances. Grant the disability pension only on medical grounds rather than on "social criteria" as permitted under the current system. Increase the activation of older workers and persons on disability schemes with some work capacity.

Reform the unemployment benefit system

Net replacement rates after long unemployment spells, taking into account taxation and social benefits received by the unemployed, are among the highest in the OECD. This reduces incentives to work.

Actions taken: Following the 2005 reform of the income-support system for the long-term unemployed, intensified activation is now required after 500 days and receipt of unemployment benefits will become conditional on participating in active labour market programmes.

Recommendations: Reduce the financial support available to the long-term unemployed to increase the incentive to take up work.

Other key priorities

- Promote employment and economic flexibility by negotiating a larger share of annual wage increases at the firm level and allowing opt-out clauses from central collective agreements, thus making wages more responsive to local conditions.
- Further deregulate product markets, in particular by easing regulations on shop opening-hours and relaxing zoning laws to facilitate entry in retail distribution, and continue the on-going privatisation process.

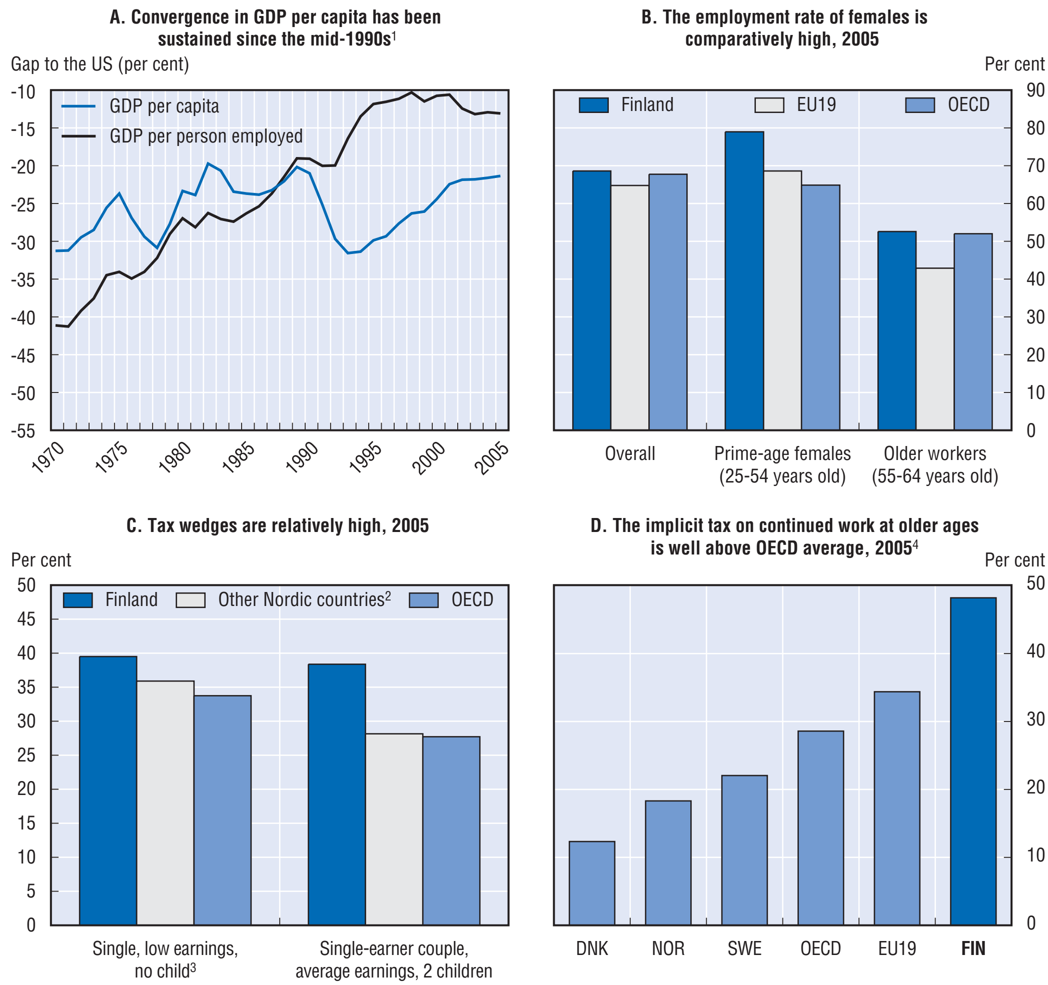
FINLAND

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	2.5	2.3	2.7
Labour utilisation	–0.1	–0.5	0.2
of which: Employment rate	0.2	–0.2	0.5
Average hours	–0.3	–0.3	–0.2
Labour productivity	2.6	2.7	2.5
of which: Capital intensity	0.1	0.3	–0.1
Multifactor productivity	2.5	2.4	2.6

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Average of Denmark, Iceland, Norway and Sweden.
3. Low earnings refer to two-thirds of average earnings.
4. Average of implicit tax on continued work in early retirement route for 55- and 60-year-old workers.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Taxing Wages 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/10.1787/716436587346*

FRANCE

Relatively weak growth in labour utilisation and productivity has resulted in a further widening of the GDP-per-capita gap vis-à-vis *the best performing countries. The gap largely reflects low labour utilisation.*

Priorities supported by indicators

Reduce the minimum cost of labour

Compared with other OECD countries, the minimum cost of labour is high relative to the median, lowering demand for labour, especially for young and low-skilled workers.

Actions taken: No reductions in social security contributions have taken place since those associated with the implementation of the 35-hours legislation. However, in late 2006, the government proposed further reductions for 2007.

Recommendations: Limit future increases in the minimum wage so as to allow the minimum cost of labour to fall in relative terms. If possible, given budgetary constraints, proceed with the proposed cuts in social security contributions or with increases in the earned-income tax credits to improve net income for low-wage workers.

Reform employment protection legislation

Procedures for dismissals of permanent workers are complex, especially in comparison with those for temporary workers, and the required legal justifications are strict, making outcomes difficult to predict. Also, obligations for firms to help redundant workers to find a job are burdensome. All this discourages hiring of workers on permanent contracts, with particularly detrimental effects on the jobs prospects of specific groups, such as youth, creating a segmented labour market that may erode efficiency in the long run.

Actions taken: The government introduced special contracts (the "*Contrats Nouvelles Embauches*") for firms with up to 20 employees that give employers wide flexibility to terminate the contract during the first two years, although severance payments in this period are quite high.

Recommendations: Continue efforts to ease statutory employment protection and move towards a simplification of the legislation and an increase in the predictability of dismissal costs. Promote the creation of a single contract where the degree of protection increases with the length of service.

Reduce regulatory barriers to competition

In a number of sectors, mainly retail distribution and some network industries, competition is restricted by the regulatory framework, thereby reducing productivity growth and also hindering the development of employment.

Actions taken: Retail price regulation has been modified to alter the definition of illegally selling below cost, so as to lower prices to consumers, although the new definition is more complex. Action in the electricity sector has been limited to the implementation of EU directives.

Recommendations: Promote consumer welfare as the principal objective of competition policy and regulatory reform, and do not allow special-interest groups to define the goals. Abolish restrictions on selling below cost, which impede price competition in the retail sector, as existing rules on abuse of dominance should be sufficient. Remove regulatory entry barriers to potentially competitive sectors and enforce non-discriminatory access in the non-competitive components of network industries.

Other key priorities

- Reduce the implicit tax on continued work at older ages. Implement plans to suppress the *Delalande* contribution, which imposes an additional penalty for firms dismissing workers over 50 years, and to improve incentives to continue working at older ages. Remove the job-search exemption for older workers receiving unemployment benefits.
- Raise funding for tertiary education by allowing public higher-education institutions to charge cost-related fees (not necessarily full-cost recovery) for all students, while expanding the provision of means-tested grants to maintain accessibility. A student loan scheme should also be introduced, but with income-contingent repayments.

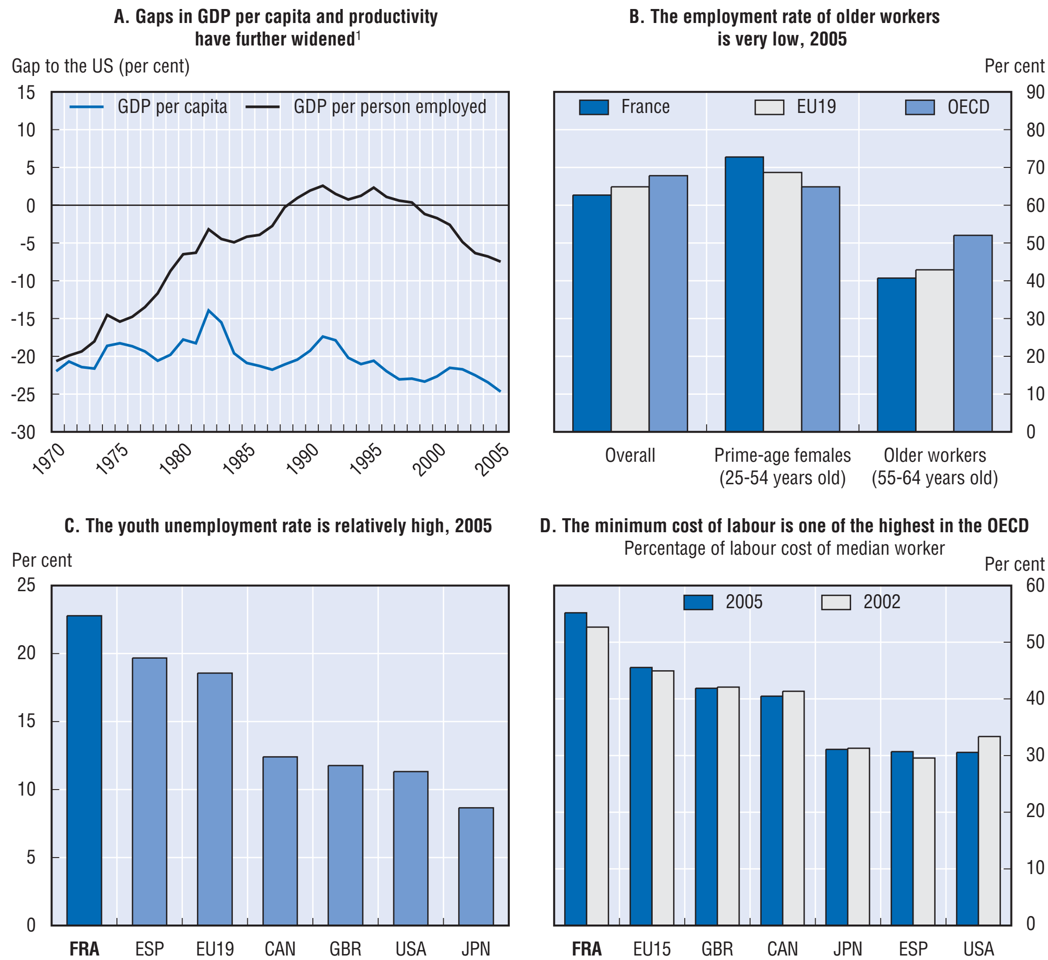
FRANCE

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	1.6	1.8	1.4
Labour utilisation	–0.1	0.1	–0.4
of which: Employment rate	0.5	0.8	0.2
Average hours	–0.6	–0.6	–0.6
Labour productivity	1.7	1.7	1.8
of which: Capital intensity	0.8	0.8	0.9
Multifactor productivity	0.9	0.9	0.9

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Charts B and C: OECD, *Labour Force Statistics*, 2006; Chart D: OECD, Taxing Wages and Minimum Earnings databases.

StatLink: *http://dx.doi.org/10.1787/716436587346*

GERMANY

The gap in GDP per capita vis-à-vis *best performing countries has continued to widen. Long-term unemployment is high and annual hours worked per employed worker are low.*

Priorities supported by indicators

Reduce average tax wedges on labour income

The average tax wedges on two-earner households and single earners are high in comparison with other OECD countries, mostly on account of high social charges, reducing incentives to work.

Actions taken: The government is using a significant proportion of revenues resulting from the 2007 VAT increase to lower social charges. Spending on ineffective active labour market policies has been reduced and the statutory pension age has been raised, creating scope to curb social charges.

Recommendations: Lower social security contributions and finance the reductions by widening the scope for selective contracting and managed care in the health-care system, and by further streamlining active labour market programmes, as well as by further reducing tax expenditures and subsidies to the business sector.

Improve the efficiency of the education system

The share of 15 year-olds attaining weak educational results is large. While upper-secondary graduation rates are high, the tertiary graduation rate is among the lowest in the OECD, potentially narrowing the skill base for innovation activities.

Actions taken: The states have agreed on some minimum standards for secondary schools and are introducing centralised examinations more widely. Funding for providing full-time education has been raised. University study fees: coupled with income-contingent repayments, have been introduced in some states. Budgetary autonomy of universities has been strengthened.

Recommendations: Evaluate performance of all schools against nation-wide standards. Give schools more autonomy. Postpone the age of selection into different school tracks. Raise coverage of early childhood education. Further raise autonomy and outcome-oriented funding of universities. Extend study fee schemes in tertiary education to all states, together with loans with income-contingent repayments.

Reduce regulatory barriers to competition

Regulations in many activities limit competition with adverse effects on productivity. Regulations of professional services are more restrictive than OECD average. Also, special qualification-related entry requirements still reduce competition in the crafts. Moreover, administrative burdens on enterprises are excessive. In addition, entry of new firms has been lacking in most network industries.

Actions taken: A more effective regulatory regime for network access has been introduced in the energy industry and a regulator has been established for all network industries. Administrative costs resulting from, for example, statistical reporting duties have been lowered. Some states have introduced regulatory impact analysis.

Recommendations: Remove the additional qualification-related requirements which are specific to opening a business in the crafts. Deregulate the liberal professions by abolishing compulsory membership in associations. Further facilitate non-discriminatory entry in the network industries and accelerate privatisation.

Other key priorities

- Improve the placement of long-term unemployed into jobs by assigning administrative responsibilities related to job placement more effectively, strengthening conditionality of benefit receipt on willingness to take up work and revisiting benefit levels.
- Reduce impediments to full-time female labour force participation by improving access to child-care facilities and to full-day schooling, as well as by lowering the tax burden on households' second earners, which could be achieved by introducing a health insurance charge for the coverage of non-working spouses.

GERMANY

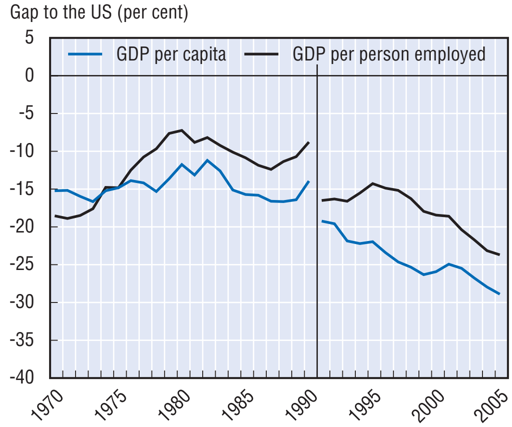
Structural indicators

Average annual trend growth rates, per cent

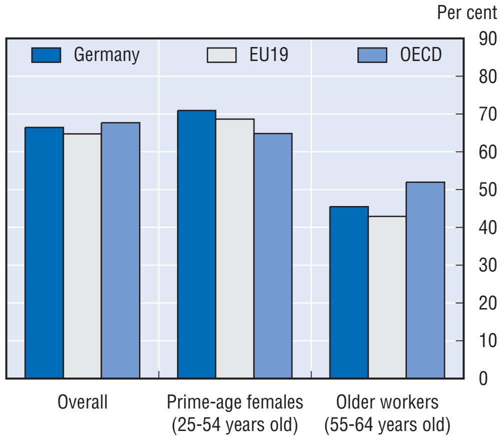
	1995-2005	1995-2000	2000-05
GDP per capita	1.4	1.4	1.4
Labour utilisation	–0.5	–0.6	–0.3
of which: Employment rate	0.2	0.1	0.2
Average hours	–0.6	–0.7	–0.5
Labour productivity	1.8	2.0	1.7
of which: Capital intensity	0.9	1.0	0.7
Multifactor productivity	1.0	1.0	1.0

Source: Estimates based on *OECD Economic Outlook*, No. 80.

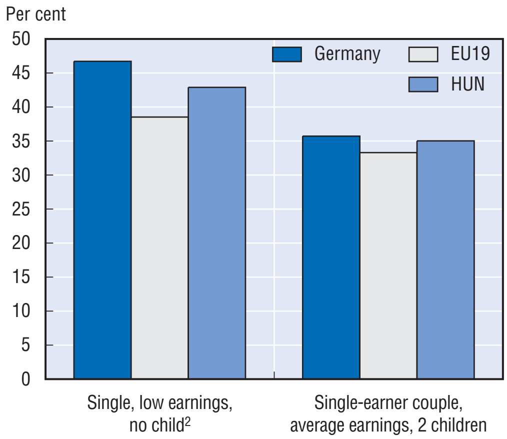
A. Gaps in GDP per capita and productivity have continued to widen[1]



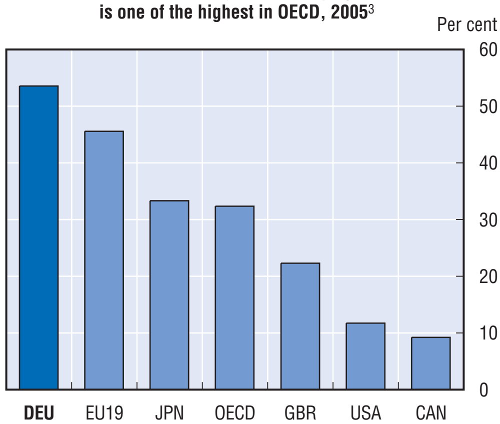
B. Employment rates are close to the OECD average, 2005



C. Tax wedges are comparatively high, 2005



D. The incidence of long-term unemployment rate is one of the highest in OECD, 2005[3]



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs). Break in the series in 1991, due to the reunification.
2. Low earnings refer to two-thirds of average earnings.
3. Persons unemployed for 12 months and over as a percentage of total unemployment.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Taxing Wages database; Chart D: *OECD Employment Outlook*, 2006.

StatLink: *http://dx.doi.org/10.1787/716436587346*

GREECE

Economic growth has been brisk but the gap in GDP per capita with best performing countries remains large because of productivity and labour utilisation shortfalls.

Priorities supported by indicators

Reduce implicit tax on continued work at older ages

The pension system discourages continued work at older ages because of high statutory replacement rates, tenuous links between contributions and benefits and the possibility of retirement after 37 years of employment regardless of age. An important channel for early retirement is via disability schemes or under special provisions for those in "arduous" occupations, not always narrowly defined.

Actions taken: The government has announced a consultation process on the long-term sustainability of the system.

Recommendations: Remove disincentives to work at older ages by better linking pension benefits to lifetime contributions so as to increase the degree of actuarial fairness. Implement stricter eligibility criteria for disability pensions and define more narrowly the categories benefiting from the arduous-work clause.

Reform employment protection legislation

Employment protection legislation weakens labour demand for "outsiders" and contributes to low labour turnover, hindering progress in reducing the large gender/age imbalances in unemployment and hampering innovation activities.

Actions taken: Recent legislation has abolished permanent contracts for new employees in all public enterprises and entities.

Recommendations: Rebalance employment protection for different occupations, in particular reduce high severance payments for white-collar workers to bring them in line with those for blue-collar workers.

Reduce barriers to entry in network industries

Despite substantial progress in privatising state-owned enterprises, the government retains a large stake in major utilities and competition is still limited in key network industries, adversely affecting economy-wide efficiency.

Actions taken: Two laws were enacted at end-2005 providing for the complete liberalisation of the electricity market from July 2007 and for the gradual liberalisation of the natural gas market. The role of the energy sector's regulator was also enhanced.

Recommendations: Privatisation limits should be abolished for all public enterprises. Assuring competition in the newly liberalised markets should be given high priority, particularly through strong and independent regulators and a reduction in vertical integration, where appropriate.

Other key priorities

- Make the higher education system more efficient, raising its standards to international levels, by introducing performance-based funding and allowing the establishment of private universities. Also, impose limits on the study duration and consider introducing study fees accompanied by a loan-scheme with income-contingent repayments.
- The minimum cost of labour should be reduced by introducing a sub-minimum wage for young people and allowing for the possibility of opting out of the national minimum wage in regions with high unemployment. Social security contributions for the low-paid should be reduced, financed by savings elsewhere in the budget.

GREECE

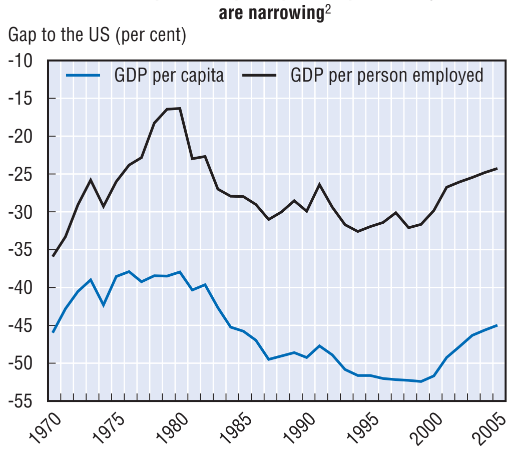
Structural indicators[1]

Average annual trend growth rates, per cent

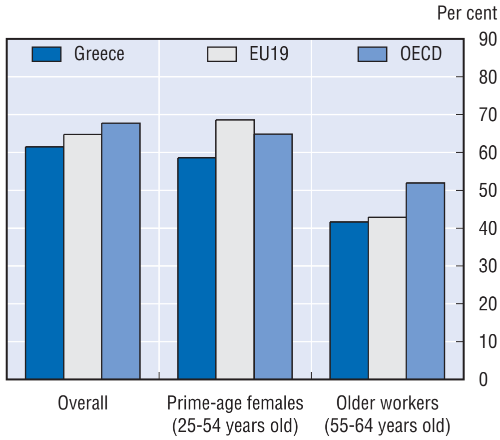
	1995-2005	1995-2000	2000-05
GDP per capita	3.0	2.4	3.5
Labour utilisation	0.3	0.0	0.5
of which: Employment rate	0.3	0.0	0.6
Average hours	0.0	0.0	0.0
Labour productivity	2.7	2.4	3.0
of which: Capital intensity	1.4	1.3	1.6
Multifactor productivity	1.3	1.1	1.4

Source: Estimates based on *OECD Economic Outlook*, No. 80.

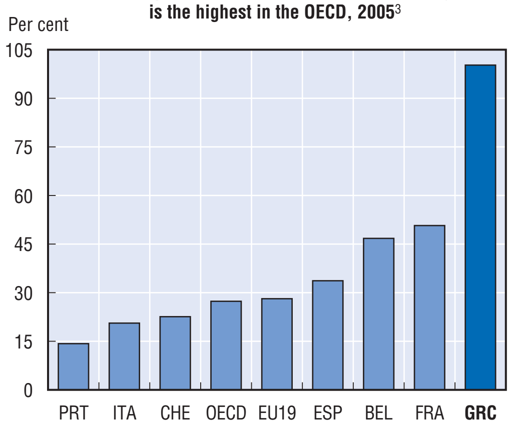
A. Gaps in GDP per capita and productivity are narrowing[2]



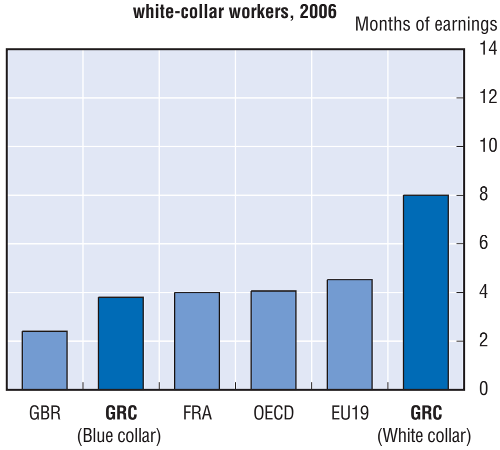
B. Employment rates are lagging behind, 2005



C. The implicit tax on continued work at older ages is the highest in the OECD, 2005[3]



D. Severance pay at 20 years' tenure is high for white-collar workers, 2006



1. Because of incomplete backward revisions at the time of publication, figures reported in the table and Chart A do not incorporate the major revision to national accounts announced in 2006.
2. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
3. Implicit tax on continued work embedded in the regular old-age pension scheme, for 60-year-olds.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; 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 Employment Outlook* (Chapter 2), 2004 and OECD calculations.

StatLink: *http://dx.doi.org/10.1787/716436587346*

HUNGARY

GDP per capita continues to converge on that of the best performing countries, but the gap remains large because of relatively low levels of productivity and labour utilisation.

Priorities supported by indicators

Reduce the tax wedge on labour income

A relatively high tax wedge on labour is hindering job creation. The wedge reflects the large revenue requirements needed to cover high level of government spending, but also narrow tax and contribution bases because of significant shadow-economy activity.

Actions taken: The employers' lump-sum healthcare contribution and other employer contributions for certain groups of workers have been reduced, personal income taxes have been cut and special tax allowances introduced. However, the wedge will increase in 2006 and 2007 as part of a revenue-based effort to bring down the large government deficit.

Recommendations: Reduce tax wedges over the medium term and finance the reduction by cutting public spending. The special tax allowances have made marginal tax incentives too complex and a universal tax allowance would be a better solution. Less costly ways are needed to reach family policy objectives than the currently very high support via taxes and benefits.

Further reform the disability benefit system

The disability benefit system has ended up providing welfare to a much wider group than originally intended because eligibility conditions have been too light or inadequately enforced, contributing to the low employment rate, especially among older cohorts.

Actions taken: Assessment of disability has been centralised following a bribery scandal and medical guidelines have been streamlined.

Recommendations: Take more account of remaining abilities when assessing the extent of disability and reduce the stock of disabled by increasing the emphasis on rehabilitation.

Improve the efficiency of the education system

Tertiary-level educational attainment by the working-age population is relatively low, restraining productivity advances and the capacity to introduce new technology. However, tertiary enrolment rates are rising rapidly, but this has put considerable pressure for change in both tertiary and secondary education.

Actions taken: In tertiary education, new three-year bachelor-level courses with more vocational content have been introduced. In secondary education, there is more emphasis on work-related skills, including languages, and a new school and pupil evaluation system is being implemented. Future reform plans include the introduction of tuition fees in tertiary education.

Recommendations: Implement the planned tuition-fee system and continue with curricula reform. Address incentive problems in teachers' pay scales but also cut back on the level of job protection which undermines efforts to address under-performance and prevents a rejuvenation of the profession.

Other key priorities

- Increase public spending efficiency by moving ahead with plans to make the public administration more accountable and to ensure the cost-efficient delivery of public services. At the municipal level, there is scope to strengthen co-operation by reinforcing the joint provision of services.
- Reduce shadow-economy activity by tying access to health care services to the payment of contributions, re-balancing social benefits towards more employment-friendly forms and raising sanctions to deterrent levels. Reconsider the recently introduced system of minimum wages according to educational achievement; the new system discourages the use of cash payments, but undermines labour market efficiency.

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HUNGARY

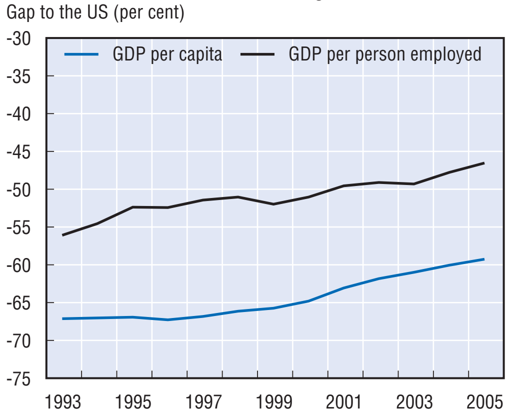
Structural indicators

Average annual trend growth rates, per cent

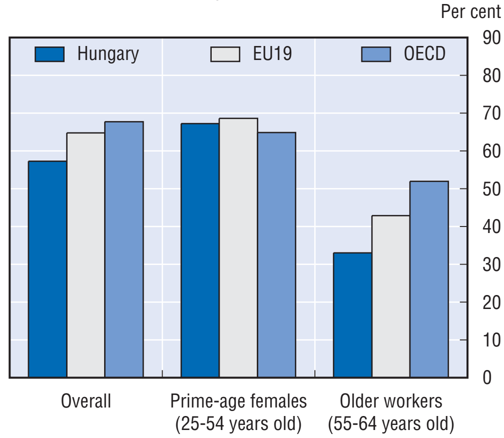
	1995-2005	1995-2000	2000-05
GDP per capita	4.4	4.0	4.7
Labour utilisation	1.0	1.1	0.9
of which: Employment rate	1.0	0.8	1.1
Average hours	0.0	0.2	–0.2
Labour productivity	3.4	2.9	3.8
of which: Capital intensity	. .	. .	. .
Multifactor productivity	. .	. .	. .

Source: Estimates based on *OECD Economic Outlook*, No. 80.

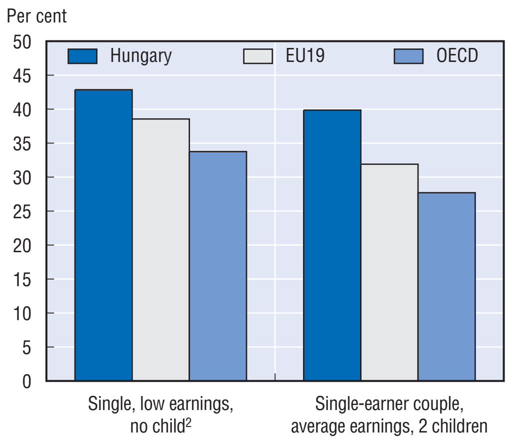
A. Gaps in GDP per capita and productivity are narrowing but remain large[1]



B. The employment rates of older workers is very low, 2005

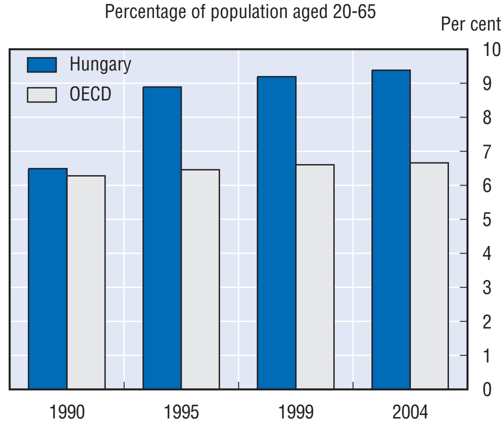


C. Tax wedges are relatively high, 2005



D. The share of working-age population receiving disability benefit is high

Percentage of population aged 20-65



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Low earnings refer to two-thirds of average earnings.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Taxing Wages database; Chart D: OECD, *Transforming Disability into Ability*, 2003 and OECD calculations.

StatLink: *http://dx.doi.org/10.1787/574285742117*

ICELAND

Over the past decade, convergence with the best performing countries has resumed, but – contrary to GDP per capita – labour productivity is still relatively low.

Priorities supported by indicators

Reduce producer support to agriculture

Support to agricultural producers is still more than twice the OECD average, and prices of agricultural products are more than three times higher than those in world markets. This entails a heavy burden for consumers and taxpayers alike, while maintaining excess resources in low-productivity activities.

Actions taken: The abolition of remaining administered prices has been postponed indefinitely, and a framework agreement on support to dairy farmers, which is highly distorting, excludes any changes until 2012.

Recommendations: Facilitate market access and reduce the very high levels of support, in particular the most trade distorting type.

Improve upper-secondary education attainment

While participation in tertiary education is high, the proportion of the working-age population with only lower-secondary education is still significant, even among young people.

Actions taken: New legislation aimed at maintaining quality standards of higher education in the face of strong student inflows has been passed, and the authorities are planning to reduce the duration of upper-secondary education, which is long by international comparison.

Recommendations: The reduction in the length of upper-secondary education should be matched by increasing effective teaching time and curriculum adjustment so that core competence achievement is not weakened.

Lower barriers to entry for domestic and foreign firms

High barriers to the entry of domestic and foreign firms remain in a few sectors, notably energy and fisheries, limiting competition, with potentially adverse effects on productivity performance.

Actions taken: The sale of the public stake in Iceland Telecom has been completed, but there has been no progress as to the privatisation of the public electricity company and reducing foreign ownership restrictions in fisheries.

Recommendations: Reduce foreign ownership restrictions in fisheries and the energy sector. Consider privatising the National Power Company's generation activities in order to level the playing field between the incumbent and entrants.

Other key priorities

- To reduce distortions in the mortgage market, the Housing Financing Fund should be charged a fee reflecting its benefits of a government guarantee.
- To enhance efficiency and curb spending creep, accelerate the introduction of outcome-based budgeting, performance measurement and management reforms in the public sector.

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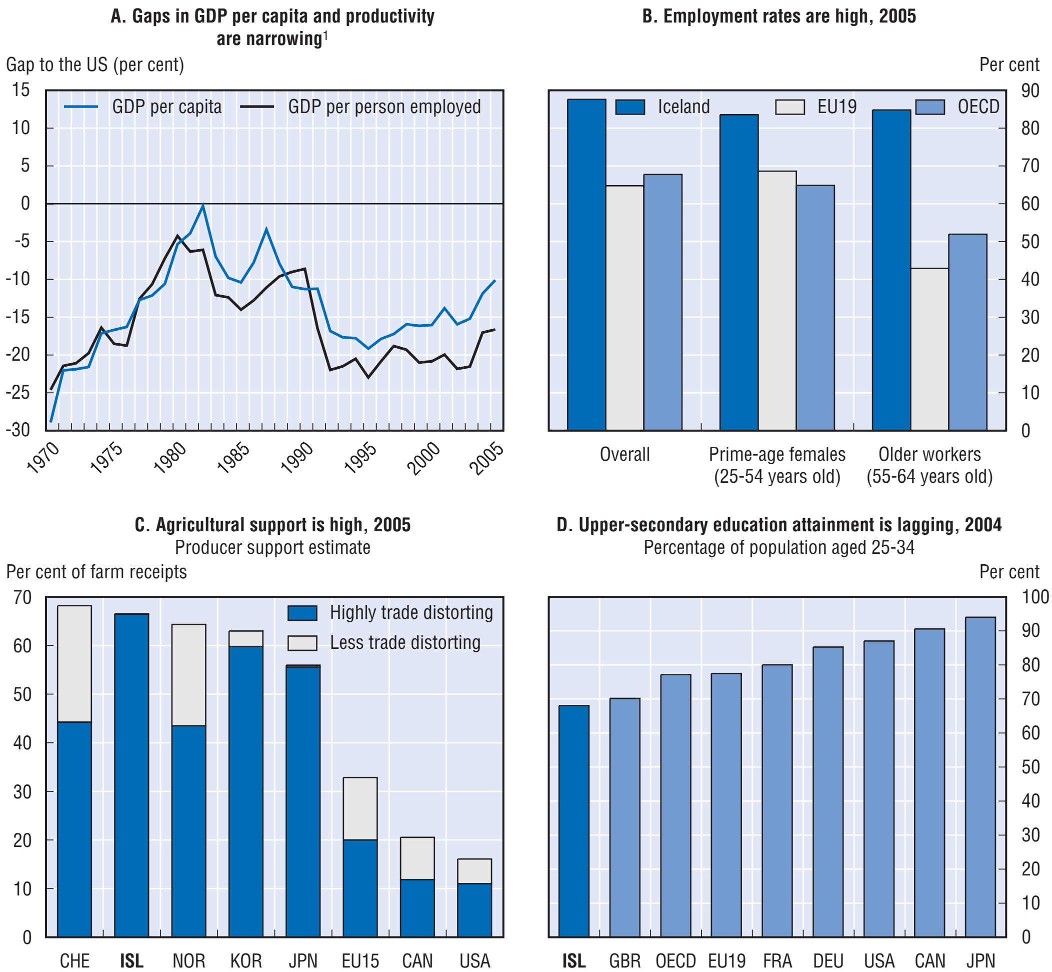
ICELAND

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	2.5	2.5	2.4
Labour utilisation	0.2	0.5	–0.1
of which: Employment rate	0.4	0.5	0.3
Average hours	–0.2	0.0	–0.4
Labour productivity	2.2	2.0	2.4
of which: Capital intensity	0.3	0.1	0.5
Multifactor productivity	1.9	1.9	1.9

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Producer and Consumer Support Estimates database; Chart D: OECD, *Education at a Glance*, 2006.

StatLink: *http://dx.doi.org/10.1787/574285742117*

IRELAND

Over the past 15 years, growth in GDP per capita has been the fastest in the OECD. However, labour participation has reached only the OECD average and further efficiency gains can be achieved in some areas.

Priorities supported by indicators

Strengthen work incentives for second earners and lone parents with young children

The rapid growth of the economy owes a lot to the rising participation of women. Nonetheless, the huge rise in participation was from such a low level that the female participation rate is still below the OECD average.

Actions taken: Support for families with children was increased substantially in the 2005 Budget but in an unconditional way, and therefore does not improve work incentives by as much as it could. The creation of childcare places is being subsidised.

Recommendations: Continue to reduce average and marginal effective tax rates on low-income second earners. Tie childcare support such as the Early Childcare Supplement to employment or the use of childcare services and phase out the Home Carer's Tax Credit. Provide job-search assistance to lone parents while strengthening their job-search requirements. Reduce the phase-out rate of the One Parent Family Payment.

Strengthen competition in network industries

Insufficient competition in the electricity, telecommunications and transport sectors raises prices, creates bottlenecks and holds back growth.

Actions taken: Plans have been presented to provide additional electric inter-connection capacity with the United Kingdom.

Recommendations: Split up the incumbent electricity company by separating the transmission grid from the generation capacity. Investigate competitive practices in the telecommunications sector and speed up unbundling. Liberalise bus routes.

Improve access to education

Pre-school attendance of young children is low. In secondary schools, too many young people are leaving without upper-secondary qualifications, while higher education is under-funded.

Actions taken: Primary school curricula have been revised.

Recommendations: Generalise pre-primary education from the age of three. In primary and secondary education, step up efforts to help children with learning difficulties. Increase tertiary education funding by levying tuition fees backed by student loans with income-contingent repayments.

Other key priorities

- Close infrastructure gaps in a cost-efficient fashion. Speed up the planning process. Fully charge all users of water supply and sewage treatment services, and introduce a congestion charge in Dublin.
- Improve governance and streamline the funding of research institutions and innovation-support programmes. Concentrate resources on a few centres of excellence in order to improve their quality and reach critical mass.

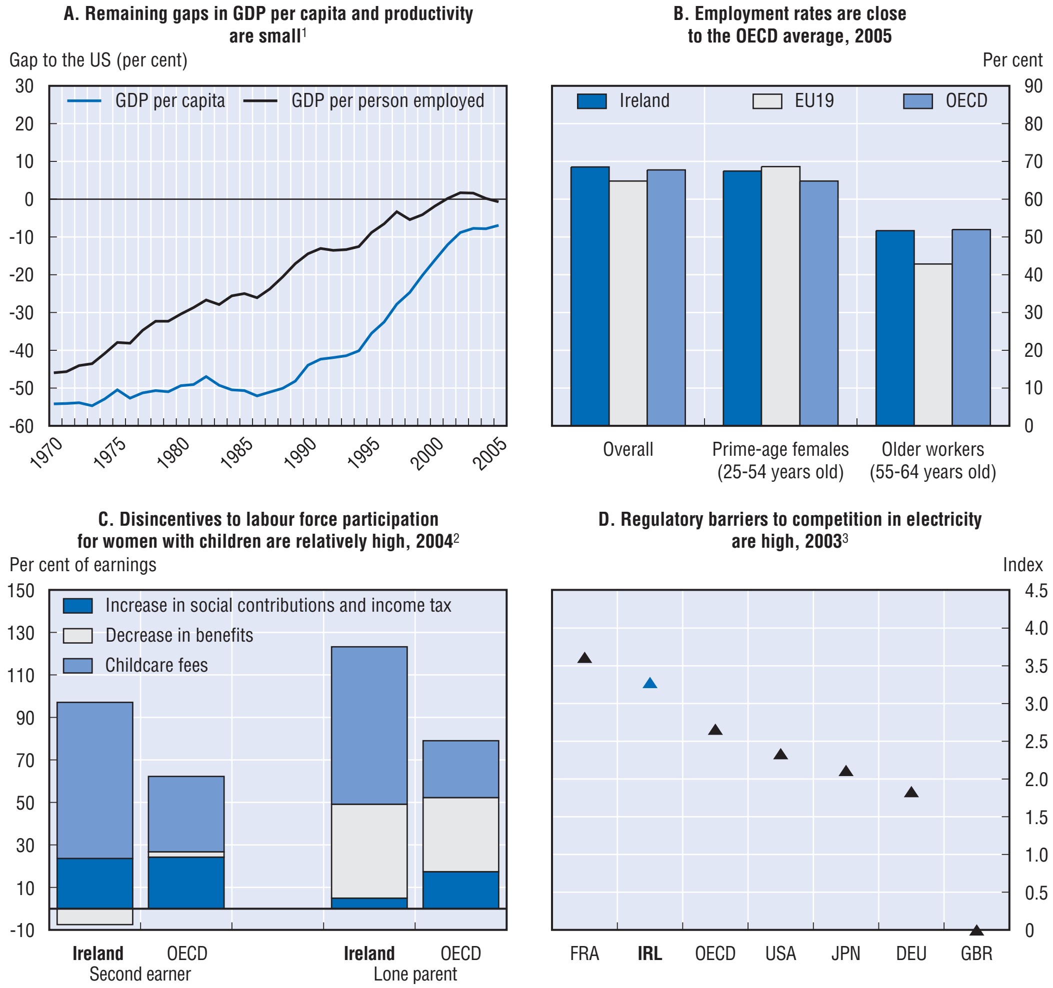
IRELAND

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	5.4	6.6	4.2
Labour utilisation	1.2	1.7	0.7
of which: Employment rate	2.1	2.8	1.5
Average hours	–1.0	–1.1	–0.8
Labour productivity	4.2	4.9	3.5
of which: Capital intensity	1.3	1.2	1.3
Multifactor productivity	2.9	3.7	2.2

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 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 lone parent with income equal to two-thirds of average earnings.
3. Indicator scale of 0-6 from least to most restrictive.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, *Benefits and Wages: OECD Indicators*, 2007, forthcoming; Chart D: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/574285742117*

ITALY

Recorded labour productivity growth has been very weak in recent years, contributing to a widening GDP-per-capita gap vis-à-vis *best performing countries. The employment rate has risen, but remains one of the lowest in the OECD.*

Priorities supported by indicators

Reduce regulatory barriers to competition

Strict regulations weaken competition pressures to innovate and increase productivity.

Actions taken: The "Bersani decree" of June 2006 liberalised many sectors – bus and other local public services; taxis, pharmaceuticals, notaries and other professional services; retail and wholesale trade; and insurance and banking – mainly via lowering of entry barriers and removal of price and quantity restrictions. It also strengthened consumer protection and the powers of antitrust authorities. Major privatisations are under preparation.

Recommendations: Accelerate divesture programmes, replace golden shares in companies with arm's length regulation, and further strengthen regulators and the antitrust authority. The Bersani reforms, as well as the planned reforms of local government services and network industries, should be fully implemented. Remove statutory and official authorisations that prevent the antitrust authorities from tackling the anti-competitive powers of professional associations.

Improve access to, and graduation from, tertiary education

Tertiary graduation rates are relatively low and drop-out rates high, despite high spending per student. Poor university teaching and research quality hamper innovation.

Actions taken: No action has taken place at the tertiary level.

Recommendations: Link teachers' careers to performance, introduce student co-payments and loans with income-contingent repayments, decentralise financing and management of universities, and increase international teacher and student exchanges.

Reduce tax wedge on labour income

A high tax wedge on labour incomes discourages employment of the low-skilled, especially in formal activities.

Actions taken: The second phase of income tax cuts was implemented. The 2007 Budget includes a cut in the labour tax wedge targeted to low-skilled workers and poorer regions.

Recommendations: Reduce high tax rates and pension contributions, notably on low- and middle-earnings, financed by lowering tax expenditures, strengthening tax enforcement and terminating tax amnesties.

Other key priorities

- Improve the framework for risk taking by further correcting failures in the structure of corporate governance, fully implementing the 2006 financial market supervision reform, as well as the 2005 bankruptcy reform.
- To strengthen labour utilisation, promote economy-wide decentralisation in wage bargaining, notably by taking regional differences in productivity and cost of living into account in public-sector wage-setting.

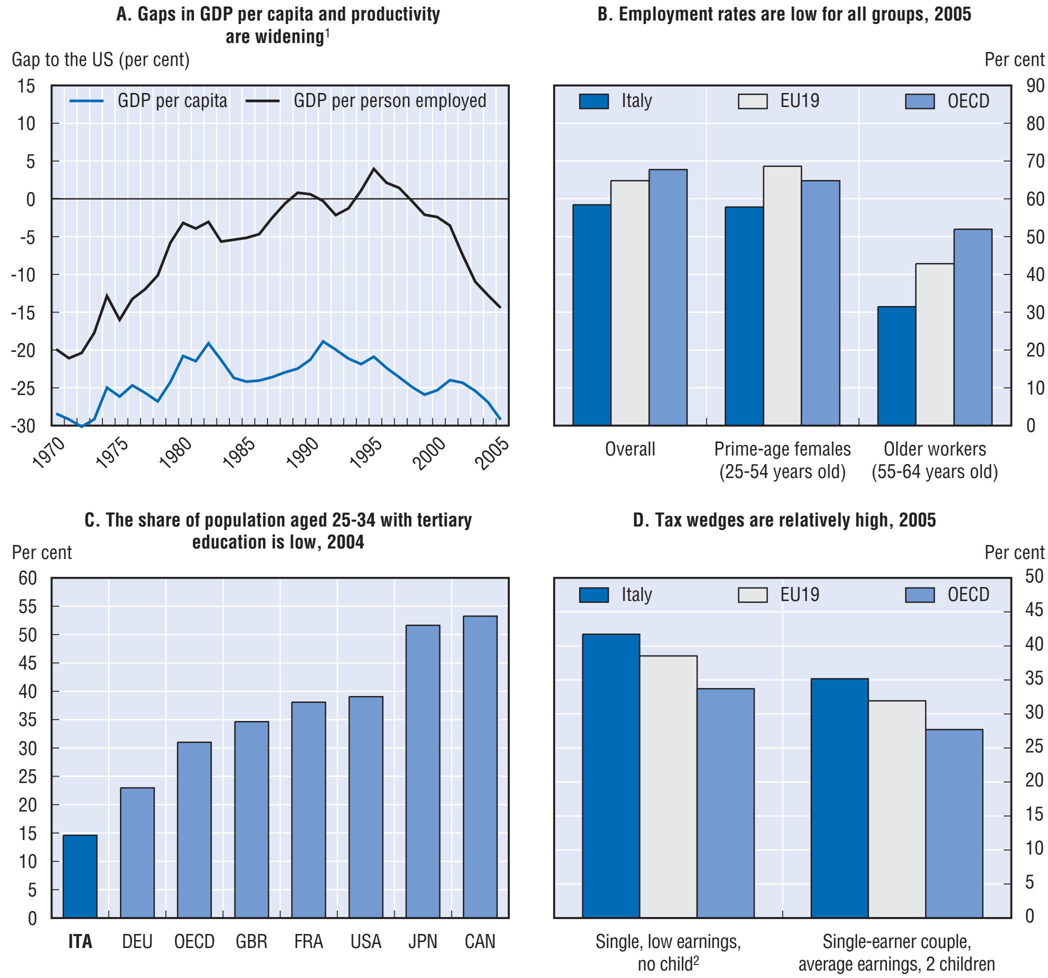
ITALY

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	1.1	1.1	1.0
Labour utilisation	–0.1	–0.2	0.0
of which: Employment rate	0.3	0.1	0.5
Average hours	–0.4	–0.4	–0.5
Labour productivity	1.2	1.4	1.0
of which: Capital intensity	1.1	1.1	1.1
Multifactor productivity	0.1	0.3	–0.1

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Low earnings refer to two-thirds of average earnings.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, *Education at a Glance*, 2006; Chart D: OECD, Taxing Wages database.

StatLink: *http://dx.doi.org/10.1787/574285742117*

JAPAN

Japan is emerging from a decade of economic stagnation, but is left with a large GDP-per-capita gap vis-à-vis *the best performing countries due to a major productivity shortfall.*

Priorities supported by indicators

Further liberalise retail and professional services

Restrictive regulations hinder competition in retail distribution and professional services, resulting in low productivity in these sectors.

Actions taken: Against the background of past relaxation of regulations on the opening of large-scale retail stores, new zoning regulations introduced in 2007 for suburban areas could lead to entry barriers for larger stores.

Recommendations: Ease policies, such as entry restrictions and zoning regulations, that may have the effect of favouring small and less productive retail stores compared with new large-scale stores. Expand the range of qualifications that permit foreign personnel to work in Japan and increase the number of sectors where foreign workers are allowed, to include non-technical areas, such as caring for the elderly.

Reform employment protection legislation for regular employment

Uncertainty about the definition of unfair dismissal applied by courts has made the requirement for dismissals less transparent and this could have discouraged the hiring of regular workers. The strictness of employment protection for regular workers has increased the proportion of non-regular workers, raising both efficiency and equity concerns.

Actions taken: No measures have been taken to ease employment protection for regular workers.

Recommendations: To remove judicial uncertainty that discourages the hiring of regular workers, more precise and transparent statutory guidelines should be established. Reduce employment protection for regular workers, thereby lowering the incentives to circumvent strict conditions by hiring non-regular workers.

Reduce producer support to agriculture

Support for agricultural producers is still far above the OECD average, boosting farm income but maintaining excess resources in low-productivity activities.

Actions taken: Beginning in 2006, the government has made limited changes, shifting towards a multi-commodity system in which support will be concentrated on larger, more efficient farms. Companies have been allowed to rent and manage agricultural land.

Recommendations: Further reduce the level of support to agriculture, while shifting its composition away from market-price supports and towards direct support for farmers to reduce the distortion of trade and production decisions.

Other key priorities

- Encourage innovation by improving framework conditions, including by removing obstacles to the development of venture capital markets. Upgrade the education system through further reducing regulation and removing barriers to entry of foreign universities.
- Raise productivity through higher foreign direct investment: remove obstacles that potential investors may face by fully opening the M&A market to foreign firms and by easing product market regulations, especially in the service sector and network industries.

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JAPAN

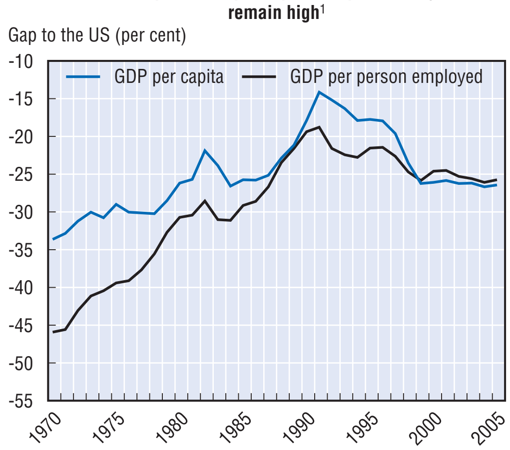
Structural indicators

Average annual trend growth rates, per cent

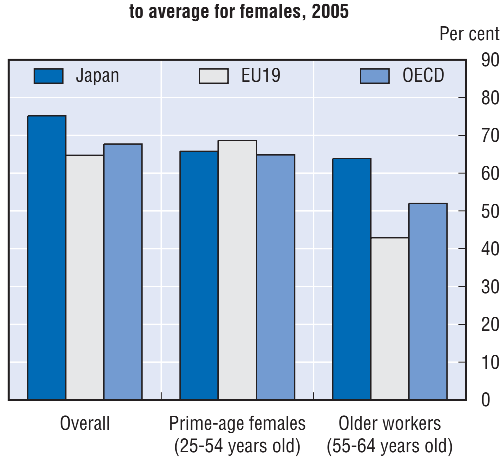
	1995-2005	1995-2000	2000-05
GDP per capita	1.2	1.0	1.3
Labour utilisation	–0.8	–0.9	–0.6
of which: Employment rate	–0.2	–0.1	–0.2
Average hours	–0.6	–0.8	–0.4
Labour productivity	2.0	2.0	1.9
of which: Capital intensity	0.8	1.0	0.7
Multifactor productivity	1.1	1.0	1.3

Source: Estimates based on *OECD Economic Outlook*, No. 80.

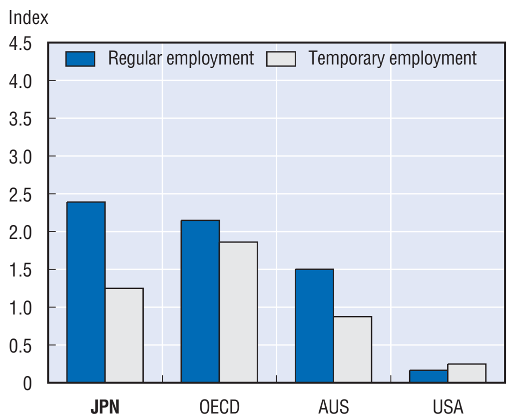
A. Gaps in GDP per capita and productivity remain high[1]



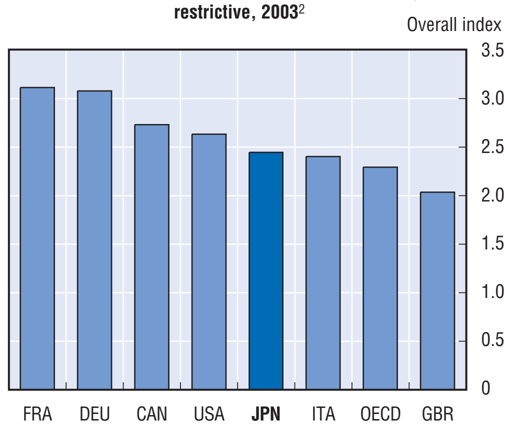
B. The overall employment rate is high but only close to average for females, 2005



C. Employment protection legislation is restrictive, 2006[2]



D. Regulations in the retail sector are relatively restrictive, 2003[2]



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Indicator scale of 0-6 from least to most restrictive.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: *OECD Employment Outlook* (Chapter 2), 2004 and OECD calculations; Chart D: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/574285742117*

KOREA

Notwithstanding continued convergence of GDP per capita, the gap with the best performing countries is still large because of the low level of productivity.

Priorities supported by indicators

Lower barriers to entry for domestic and foreign firms

The total cost, minimum capital requirement and number of procedures to start a new firm are well above the OECD average, reducing competition from potential new entrants, with adverse effects on productivity. Relatively limited inflows of foreign direct investment (FDI) further limit competitive pressures in the domestic market.

Actions taken: During 2005, the government took steps through the Regulatory Reform Committee to reform nearly 1 000 regulations out of 7 900 regulations under the responsibility of the ministries, which lead to progress in some areas, such as the deregulation of the securities industry.

Recommendations: Further reduce entry barriers through regulatory reform, particularly in the non-manufacturing sector. Encourage FDI by removing the remaining obstacles that might discourage potential foreign investors, particularly foreign-ownership restrictions in the telecommunications and electricity sectors.

Reduce producer support to agriculture

Support for agricultural producers is close to double the OECD average, creating trade distortions while maintaining excess resources in low-productivity activities.

Actions taken: The introduction of a direct income support system in 2005 is expected to reduce the share of market price support, which currently accounts for most of producer support. Government purchases of rice were abolished in 2005 and the minimum market access of rice imports is to increase from 4% of domestic consumption to about 8%.

Recommendations: Further shift the composition of assistance from market price support to direct payments, and reduce the overall level. Eliminate remaining restrictions on farm size, so as to raise productivity.

Strengthen competition in the energy sector

Restructuring in the electricity and gas industries has stalled, leaving them dominated by state-owned monopolies. Distortions in the tariff structure results in cross-subsidisation between sectors.

Actions taken: Electricity prices have been adjusted to better reflect costs. Five generating companies have been established but the plan to privatise them has stalled.

Recommendations: Create electricity generation and distribution companies that are independent of the transmission system. Increase the use of cost-reflective prices and establish independent sectoral regulators.

Other key priorities

- Improve the innovation system by strengthening linkages between research institutes in the business, university and government sectors, by enhancing intellectual property rights and by upgrading the tertiary education sector through deregulation and greater competition.
- To increase female labour force participation, expand the role of private childcare facilities by allowing more flexibility in their management and eliminating the ceiling on fees set by local governments.

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KOREA

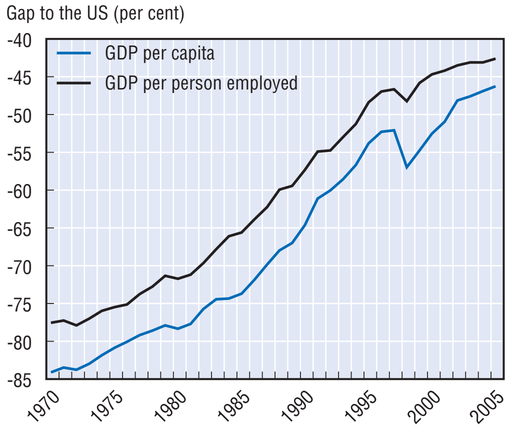
Structural indicators

Average annual trend growth rates, per cent

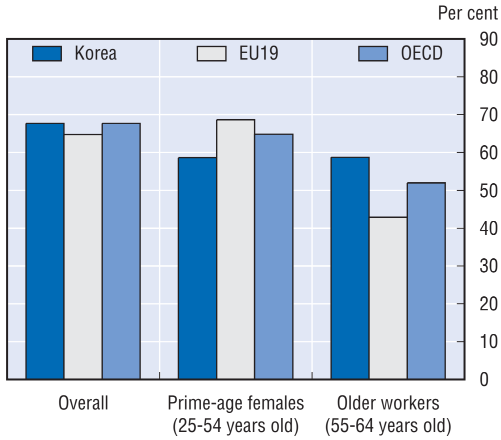
	1995-2005	1995-2000	2000-05
GDP per capita	4.2	4.4	4.0
Labour utilisation	–0.4	–0.4	–0.5
of which: Employment rate	0.6	0.5	0.6
Average hours	–1.0	–1.0	–1.1
Labour productivity	4.6	4.8	4.5
of which: Capital intensity	. .	. .	. .
Multifactor productivity	. .	. .	. .

Source: Estimates based on *OECD Economic Outlook*, No. 80.

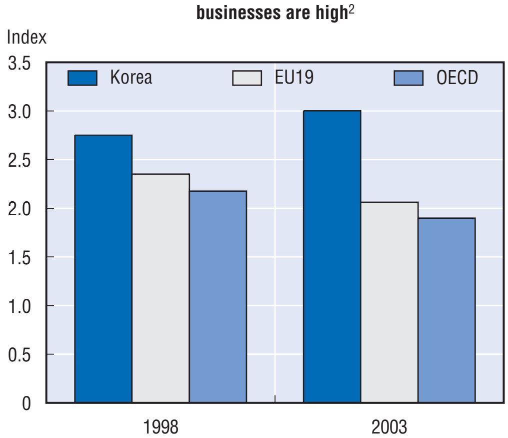
A. Convergence in GDP per capita and productivity remain strong[1]



B. Overall employment rates are high except for females, 2005

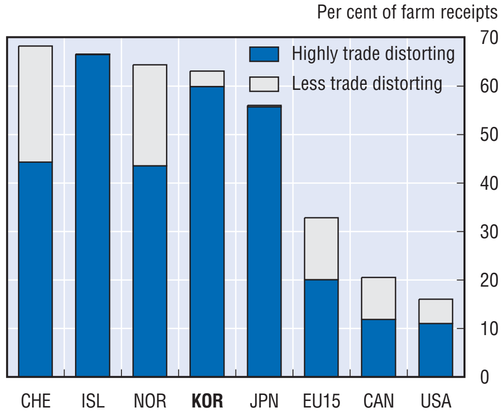


C. Administrative burdens on new businesses are high[2]



D. Agricultural support is high, 2005

Producer support estimate



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Administrative burdens to incorporate a company. Indicator scale of 0-6 from least to most restrictive.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Product Market Regulation database; Chart D: OECD, Producer and Consumer Support Estimates database.

StatLink: *http://dx.doi.org/10.1787/574285742117*

LUXEMBOURG

GDP per capita is the highest in the OECD area, thanks in part to a large proportion of cross-border workers, but labour force participation of some groups is low and productivity growth has been weak.

Priorities supported by indicators

Reduce disincentives to take up work in the income support system for the unemployed

Replacement rates – in particular for long-term unemployed and those on social assistance – are high by international standards, lowering search incentives and creating easy exit routes from the labour market.

Actions taken: No actions have been taken in recent years.

Recommendations: Tighten access conditions to unemployment benefits and gradually reduce unemployment benefit replacement rates after a certain period of benefit receipt. De-link social assistance and complementary benefits from minimum wage increases.

Improve achievement in primary and secondary education

Education outcomes have been weak as witnessed by low PISA scores and overall attainment is below OECD average, depressing employment chances for young people, in particular those with a migrant background.

Actions taken: The government has extended pre-school to 3-year-olds to help them cope with the trilingual education system and is considering allowing for grade repetition only in specific grades.

Recommendations: Compel secondary schools to offer all education tracks to facilitate track switching; offer supplementary German-language classes and increase the proportion of courses in the vocational track of secondary education taught in French.

Reduce implicit tax on continued work at older ages

Replacement rates for old-age pensions are among the highest in the OECD area, exceeding 100% of net income for lower and average income earners. This strongly discourages work at older ages. Moreover, retirement from the age of 60 is possible after 40 years of work experience, including time spent on education and child-rearing, as well as periods of unemployment for younger workers without access to unemployment benefits.

Actions taken: No recent action.

Recommendations: Raise the degree of actuarial fairness of the pension system by linking pensions to lifetime contributions. Scale back possibilities for acquiring imputed years spent on non-work activities. Index the official retirement age to life expectancy.

Other key priorities

- Boost competition in professional services by easing conduct regulation, and licensing and education requirements. Improve enforcement by the competition authorities by increasing resources. Enhance deterrence by increasing sanctions.
- Strict employment protection should be eased by simplifying rules for individual dismissals and the scope for using temporary contracts should be enlarged by allowing more renewals.

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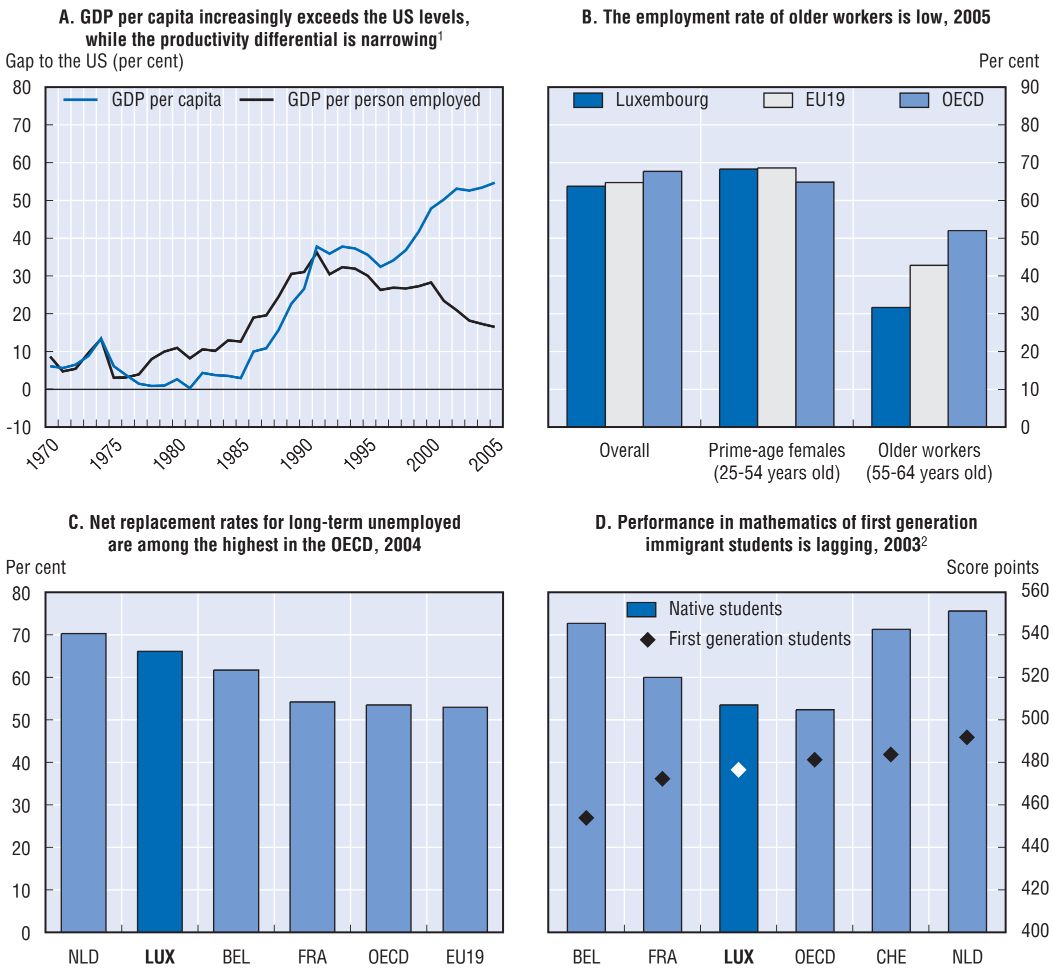
LUXEMBOURG

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	3.5	3.7	3.4
Labour utilisation	2.1	2.1	2.1
of which: Employment rate	2.7	2.7	2.8
Average hours	–0.6	–0.5	–0.7
Labour productivity	1.4	1.5	1.2
of which: Capital intensity	. .	. .	. .
Multifactor productivity	. .	. .	. .

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Students of parents who immigrated to the country.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Benefits and Wages database; Chart D: OECD, PISA 2003 database and OECD, *Education at a Glance*, 2006.

StatLink: *http://dx.doi.org/10.1787/574285742117*

MEXICO

Economic growth has been too slow to allow substantial convergence in living standards with the best performing OECD countries. The low level of labour productivity is the main source of the income gap.

Priorities supported by indicators

Raise achievement in primary and secondary education

Mexican children spend few years in school and student performance is among the weakest in the OECD, holding back productivity growth and slowing the adoption of new technologies.

Actions taken: On-going efforts are aimed at increasing the participation in upper-secondary education of students from low-income families. Modest steps have been taken to strengthen the quality of teaching. Some states have taken initiatives to improve the quality, efficiency and equity of schooling.

Recommendations: Reallocate education resources towards secondary education and non-wage spending. Raise the cost-efficiency of spending by further modernising curricula and by incorporating the results of evaluations into rewards/sanctions for teachers and schools, thereby enhancing their accountability.

Reduce barriers to entry in network industries

There are explicit barriers to entry in the electricity sector, and in oil and gas extraction. Effective competition is lacking in the telecommunications sector because of problems in applying the current law and a lack of progress in passing competition-enhancing legislation.

Actions taken: The 2006 reform to the competition law clarifies the Federal Competition Commission (CFC) procedures, streamlines merger notification, strengthens the CFC's powers and enhances the importance of its opinions for government action in regulated sectors. However, changes to the media law allow the two incumbents to strengthen their control of the spectrum available for broadcast transmissions.

Recommendations: Remove legal obstacles to private investment in the electricity, and oil and gas sectors. Review the 2006 amendments to the radio and television law to ensure that it strengthens competition in the media sector and does not, in practice, give further benefits to the incumbents at the expense of new entrants.

Reduce barriers to foreign ownership

Restrictions on foreign investment are still in place in many sectors. These hold back competition and impede technological transfer.

Actions taken: No action taken.

Recommendations: Ease restrictions on foreign direct investment (FDI), especially in the electricity sector and fixed-line telephony, as well as in some professions, construction and transportation.

Other key priorities

- Simplify the tax system and broaden the VAT base to raise labour productivity by reducing distortions and by facilitating tax administration.
- Improve the "rule of law" with more transparency, clearer property rights, and more predictable law enforcement, with a view to facilitating business and enhancing FDI inflows.

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MEXICO

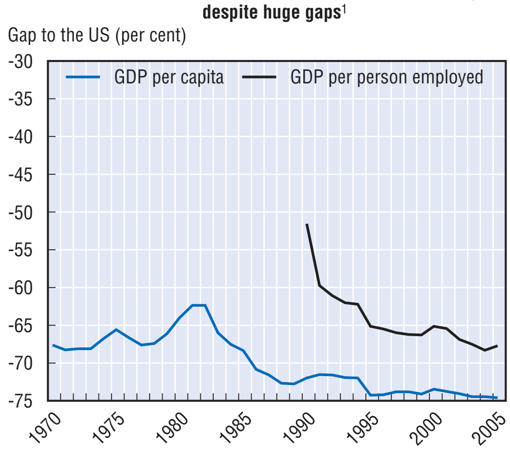
Structural indicators

Average annual trend growth rates, per cent

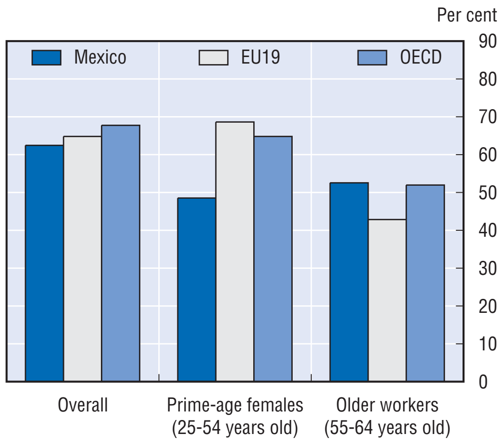
	1995-2004	1995-2000	2000-04
GDP per capita	1.6	1.2	2.1
Labour utilisation	0.8	0.9	0.8
of which: Employment rate	0.8	0.7	0.9
Average hours	0.0	0.2	–0.2
Labour productivity	0.7	0.3	1.3
of which: Capital intensity	. .	. .	. .
Multifactor productivity	. .	. .	. .

Source: Estimates based on *OECD Economic Outlook*, No. 80.

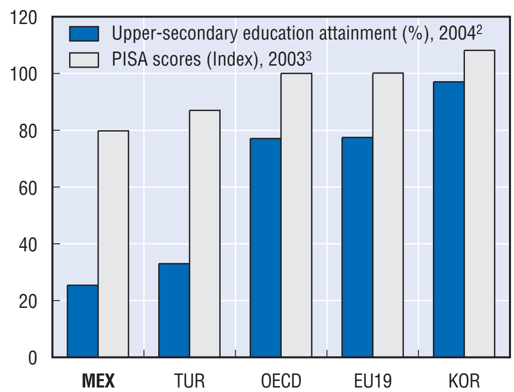
A. No convergence in GDP per capita and productivity despite huge gaps[1]



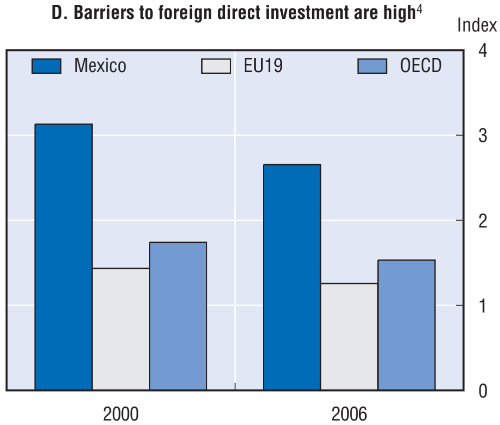
B. Overall employment rates for females are low, 2005



C. Secondary school attainment and achievement are poor



D. Barriers to foreign direct investment are high[4]



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Percentage of population aged 25-34 that has attained at least upper-secondary education.
3. Average of mean scores in mathematics, science and reading. OECD = 100.
4. Indicator scale of 1-10 from least to most restrictive.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, *Education at a Glance*, 2006 and OECD, PISA 2003 database; Chart D: Koyama, T. and S.S. Golub (2006), "OECD's FDI restrictiveness index: revision and extension to more economies", *OECD Economics Department Working Papers*, No. 525.

StatLink: *http://dx.doi.org/10.1787/574285742117*

NETHERLANDS

Labour utilisation rates are relatively low, mainly because of low average annual hours worked, combined with low employment of those aged 55 and above, and they account for the wide income gap vis-à-vis *the best-performing countries.*

Policies supported by indicators

Reform disability benefit schemes

Labour utilisation has been held back by extensive use of disability and sickness leave schemes as routes to early retirement, reflecting high benefits and negotiated supplements to such benefits that are extended by the government to cover a large part of the workforce.

Actions taken: A new disability law provides stronger financial incentives to work for those with residual work capacity.

Recommendations: Extend work capacity reassessment to beneficiaries above the age of 50 and assist the reintegration of the partially disabled into the workforce. Stop the administrative extension of wage agreements that include clauses for topping up disability benefits.

Strengthen work incentives for second earners

High marginal income taxes, combined with a steep phasing-out of childcare subsidies, weaken incentives to increase hours worked and deter low-income earners, in particular second earners, from full-time participation.

Actions taken: The taper rate for withdrawing childcare subsidies has been reduced somewhat.

Recommendations: Continue lowering effective marginal tax rates, for instance by further reducing the taper rate for withdrawing childcare subsidies for second earners.

Strengthen competition in network industries

Legal barriers to entry in network industries remain substantial and exemptions from the competition law are widespread. Local government ownership in public transport, electricity and gas hinders third-party access in these industries. Moreover, excessive licensing requirements to establish a national roadfreight business limit entry in this sector.

Actions taken: Ownership separation in the gas and electricity sectors has been achieved at the national level and the extent of exemptions from the competition law has been somewhat reduced.

Recommendations: Facilitate third-party access by securing effective vertical separation in network industries owned by local governments, introducing cost-based access pricing and privatising such activities. Adopt a "silence is consent" rule for issuing licenses.

Other key priorities

- Ease restrictions on large-format retail store operators, and remove remaining obstacles to shop-opening hours, in particular on Sundays.
- Ease land-use zoning restrictions to stimulate supply of housing.

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NETHERLANDS

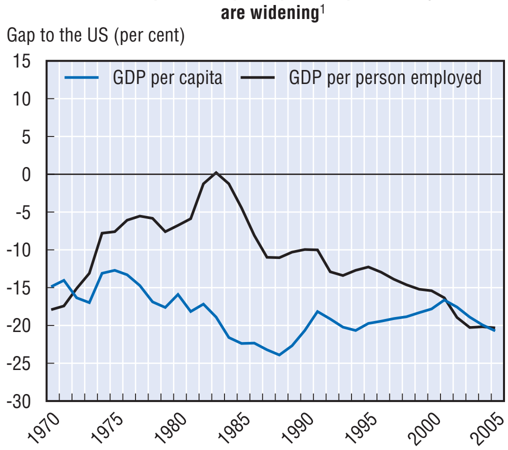
Structural indicators

Average annual trend growth rates, per cent

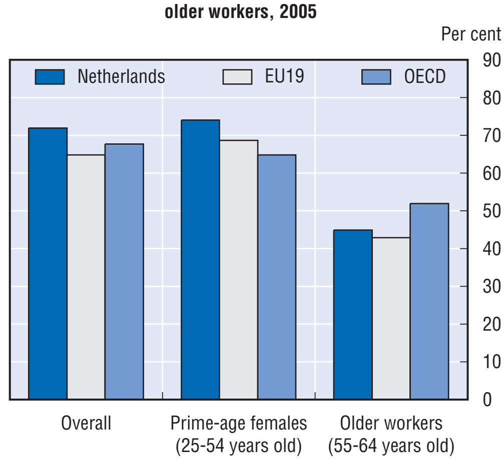
	1995-2005	1995-2000	2000-05
GDP per capita	2.0	2.2	1.8
Labour utilisation	1.2	1.4	1.1
of which: Employment rate	1.3	1.6	1.0
Average hours	–0.1	–0.3	0.1
Labour productivity	0.8	0.9	0.8
of which: Capital intensity	0.4	0.4	0.3
Multifactor productivity	0.4	0.5	0.4

Source: Estimates based on *OECD Economic Outlook*, No. 80.

A. Gaps in GDP per capita and productivity are widening[1]

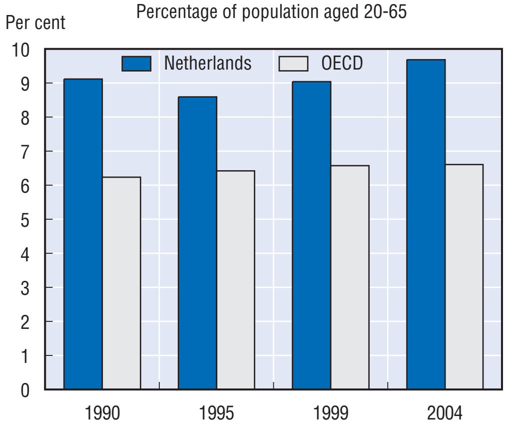


B. Employment rates are high except for older workers, 2005

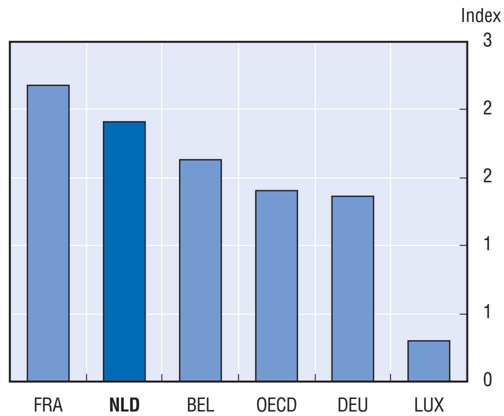


C. The share of working-age population receiving disability benefit remains high

Percentage of population aged 20-65



D. Legal barriers to entry in industries are relatively high, 2003[2]



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Indicator scale of 0-6 from least to most restrictive.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, *Transforming Disability into Ability*, 2003 and OECD calculations; Chart D: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/574285742117*

NEW ZEALAND

Growth in GDP per capita has slowed, and its level remains significantly below the OECD average, almost entirely because of lower hourly labour productivity.

Priorities supported by indicators

Improve the performance of electricity markets

Investment in electricity generation and transmission is being stymied by on-going uncertainties about the future regulatory framework and climate change policies.

Actions taken: In December 2005, the Government withdrew the carbon tax intended to come into force in 2007. In December 2006, it released a draft national energy strategy, a discussion document on climate change policy and a draft conservation and energy-efficiency strategy.

Recommendations: Rapidly establish a transparent and durable framework to reduce regulatory uncertainties and to provide incentives for efficient market-based outcomes.

Facilitate access to childcare for working parents

Access to childcare and out-of-school hours care for working parents is constrained by high out-of-pocket costs while rising regulatory standards are constraining supply. These costs, together with the withdrawal of income-tested family transfers, can result in high marginal effective tax rates and lower average hours worked, especially for second earners.

Actions taken: The means-tested childcare subsidy for low-income households has been increased by 17% since October 2004. Up to 20 hours of free weekly early childhood education for three- and four-year-olds is to be introduced in all early childhood education services run by qualified teachers from July 2007, as long as places are available.

Recommendations: Ensure that efforts to lift quality of childcare do not compromise access, especially for disadvantaged children, and that sufficient places are available for the three- and four-year-olds. Scale back income-tested transfers, and instead channel more funding into reducing out-of-pocket costs for childcare.

Reduce the extent of educational under-achievement observed among specific groups

Continued socio-economic difficulties for Maori and Pacific Island youth, in particular high unemployment rates, are linked to under-achievement in education, although the educational attainment of Maori and Pacific Island school leavers improved sharply in recent years.

Actions taken: Progress has been made in identifying evidence-based best practices and in encouraging professional development, including initiatives that focus on lifting educational achievement among Maori youth.

Recommendations: Promote greater differentiation in teacher pay according to on-going professional developments and to their success in improving educational outcomes for groups at risks of under-achievement.

Other key priorities

- Increase the incentives for public-sector managers to identify and implement efficiency improvements through well-designed performance targets supported by robust information systems, especially in health and education.
- Establish a more rational set of road-pricing arrangements, including tolls and congestion pricing, to help reduce road-transport bottlenecks and localised urban pollution.

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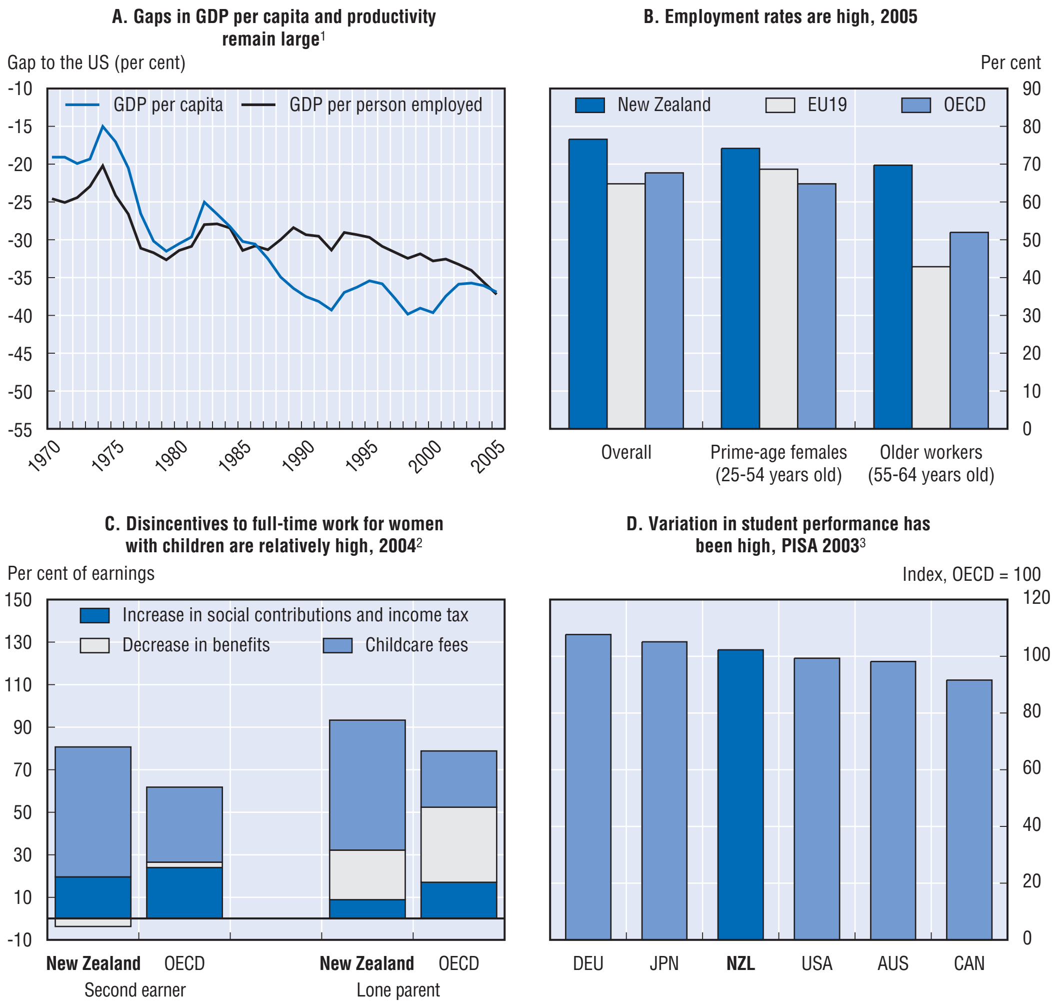
NEW ZEALAND

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	2.0	1.9	2.1
Labour utilisation	0.7	0.5	0.9
of which: Employment rate	0.8	0.5	1.1
Average hours	–0.1	0.0	–0.2
Labour productivity	1.2	1.4	1.1
of which: Capital intensity	0.7	0.8	0.6
Multifactor productivity	0.5	0.6	0.5

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 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 variation of student performance in mathematics, science and reading.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, *Benefits and Wages: OECD Indicators*, 2007, forthcoming; Chart D: OECD, PISA 2003 database.

StatLink: *http://dx.doi.org/10.1787/574285742117*

NORWAY

Mainland GDP per hour worked is one of the highest in the OECD, reflecting strong productivity growth over the past decade. However, labour utilisation is mediocre, mainly because of low annual average hours worked.

Priorities supported by indicators

Reduce the scope of public ownership

Public ownership is high and widespread, covering a broad range of sectors, such as petroleum and aluminium production, network industries, banking, telecommunications, fish-farming and chemicals. This can be detrimental to competition, foreign direct investment, innovation and growth.

Actions taken: State interest was reduced significantly in a fish-farming company, but was reinforced in an ammunition company.

Recommendations: Restart the process of privatisation, with a priority in telecommunications, banking and industry.

Reform disability and sickness benefit schemes

Labour utilisation is held back by large participation in disability schemes and extensive use of sick leave arrangements.

Actions taken: A public commission will issue a White Paper in Spring 2007 to propose options to reform the disability scheme. The employment and national insurance services were merged into a new combined public employment and welfare service to improve activation policies, including for recipients of disability benefits.

Recommendations: Introduce stricter regulation of the entitlement to sickness benefits and make mandatory the involvement of independent medical specialists in disability assessment. Make the medical/vocational rehabilitation and temporary disability programmes more effective in getting people back to work, in particular by further tightening eligibility criteria for entry into each partial and full disability categories, by improving co-ordination between medical and vocational programmes, and by requiring compulsory job search where feasible.

Reduce producer support to agriculture

Agricultural support remains among the highest in the OECD and keeps resources in low-productivity activities.

Actions taken: No significant action taken.

Recommendations: Cut high external tariffs on agricultural products and reduce public subsidies to domestic production. Decouple support from production levels and move to a system of income transfers targeted to less well-off farmers, or those in remote regions, in order to reduce trade distortions and make transparent the aims of the policy.

Other key priorities

- Implement a comprehensive pension reform in line with the 2004 proposals of the pension commission, promoting an actuarially more neutral pension system aimed at raising the effective retirement age.
- Strengthen the independence of the competition authority, some of whose decisions have been recently overruled by the government. Reduce state aid, notably regionally targeted social contribution rebates, and promote competition to maintain rapid productivity gains.

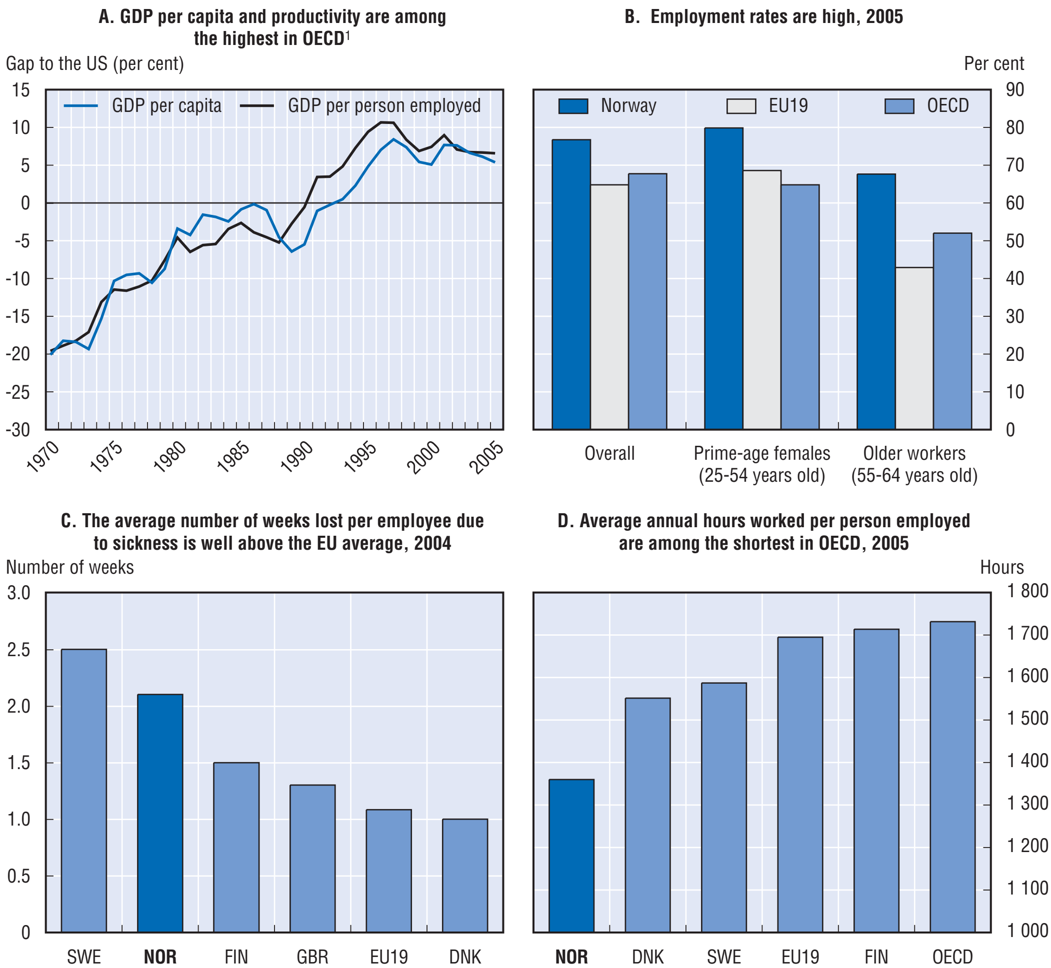
NORWAY

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	2.2	2.2	2.1
Labour utilisation	–0.2	–0.4	–0.1
of which: Employment rate	0.2	0.2	0.2
Average hours	–0.4	–0.6	–0.3
Labour productivity	2.4	2.6	2.2
of which: Capital intensity	–0.2	–0.1	–0.3
Multifactor productivity	2.6	2.7	2.6

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: *OECD Employment Outlook* (Chapter 1), 2004 and OECD calculations; Chart D: *OECD Employment Outlook*, 2006.

StatLink: *http://dx.doi.org/10.1787/532416353370*

POLAND

Despite substantial growth in recent years, GDP per capita is still well below OECD average, reflecting large gaps in both productivity and labour utilisation.

Priorities supported by indicators

Reduce public ownership

Public ownership is declining but remains the highest among all OECD countries, contributing to low investment in R&D and physical capital.

Actions taken: The process of privatisation continues, but at a slow pace and with many social and "strategic" elements incorporated into deals, which undermine the potential efficiency gains.

Recommendations: Step up privatisation and eliminate most remaining state controls exerted through residual shareholding (including special shares) kept in many privatised companies. Refrain from imposing side conditions on employment and investment in privatisation deals.

Reform the benefit and tax system to make work pay

Strong disincentives to take up work arising from the unemployment and disability benefit schemes contribute to low employment rates, including by maintaining upward pressures on tax wedges.

Actions taken: A tightening of access to disability benefits has reduced the number of new claimants of disability pension, albeit the stock of beneficiaries remains high.

Recommendations: Raise incentives for the unemployed to accept jobs or training by a further tightening of work-availability and job-search requirements in the unemployment benefit system. Lower tax rates and finance the reductions by constraining social expenditures and by broadening the tax base.

Improve efficiency of tertiary education

Rapid expansion of tertiary education since 1991 is helping to raise productivity, but there remain questions of efficiency of resource allocation between public and private institutions, and of equity among students of difficult.

Actions taken: A state body to monitor the quality of higher-education institutions (HEIs) is increasing transparency and should improve quality. Rules have been introduced to eliminate the problem of multiple job-holding among staff of public HEIs.

Recommendations: Reinforce quality control and information dissemination. Improve both equity and efficiency by introducing, in parallel, tuition fees for full-time students in public HEIs and improved systems of means-tested grants and student loans with income-contingent repayments.

Other key priorities

- Simplify regulation in professional services, and improve regulation in telecommunications so as to facilitate third-party access to the network segment.
- Strengthen geographical labour mobility by continuing to upgrade transport and communications, and by improving national integration of the public employment service. Ensure that urban planning addresses the need for housing (private and social) and transport services, while also taking into account other considerations, such as environmental factors.

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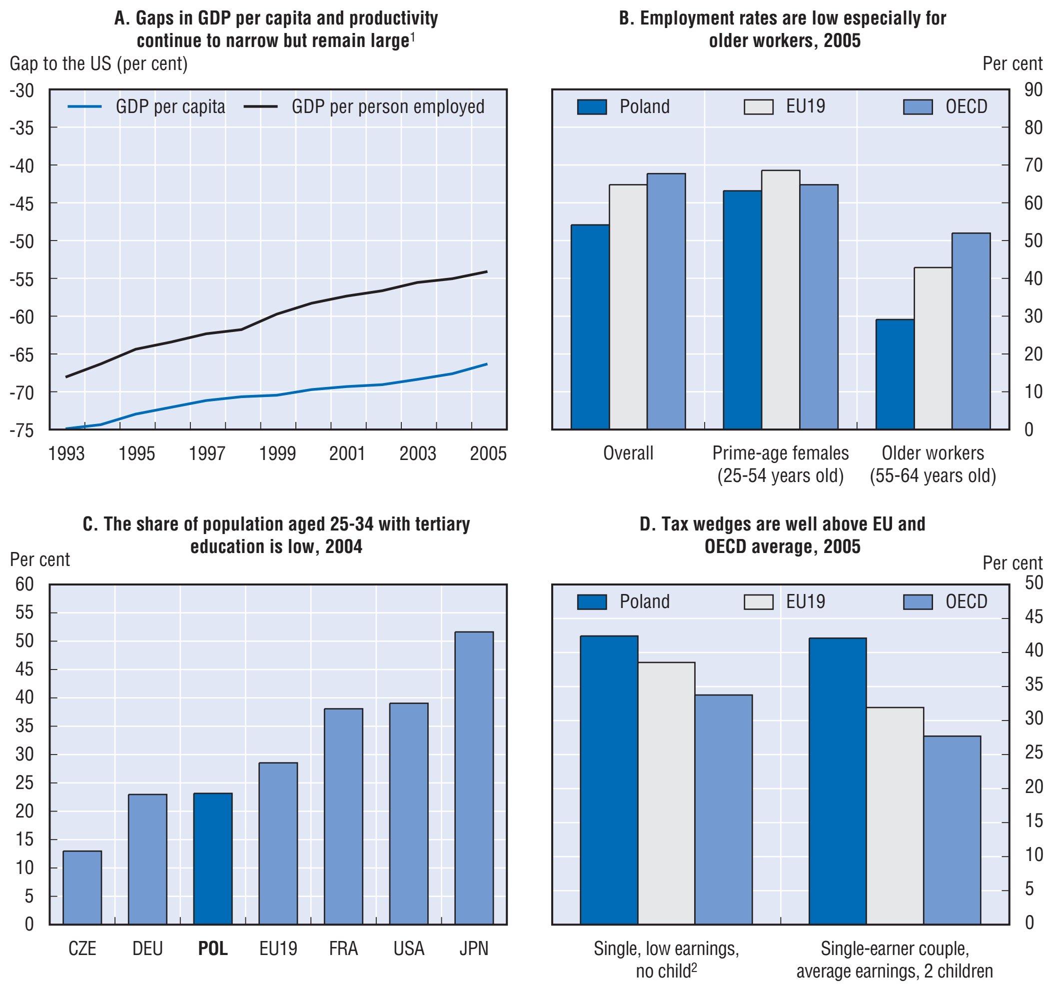
POLAND

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	4.8	5.1	4.4
Labour utilisation	. .	. .	0.4
of which: Employment rate	0.1	0.0	0.2
Average hours	. .	. .	0.1
Labour productivity	. .	. .	4.0
of which: Capital intensity	. .	. .	. .
Multifactor productivity	. .	. .	. .

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Low earnings refer to two-thirds of average earnings.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, *Education at a Glance*, 2006; Chart D: OECD, Taxing Wages database.

StatLink: *http://dx.doi.org/10.1787/532416353370*

PORTUGAL

Convergence in living standards with the OECD average has halted in recent years, with the large GDP-per-capita gap essentially reflecting low productivity.

Priorities supported by indicators

Improve upper-secondary and tertiary education attainment

Low human capital accumulation limits productivity growth and hampers the adoption of new technologies.

Actions taken: To improve efficiency, very small schools are being regrouped or closed, and better use is being made of existing teaching staff, in part by increasing the number of teaching hours. The government has launched programmes to reorganise and rationalise the tertiary education system.

Recommendations: Better use current education resources by increasing the proportion of primary and secondary spending allocated to non-wage spending. Continue on-going efforts to strengthen vocational and technical education. Implement systematic evaluation of higher education institutions.

Reduce barriers to competition

Weak competition in network industries and the services sector hampers productivity growth by reducing the incentive for firms to seek efficiency gains or adopt more advanced production techniques.

Actions taken: No major measures have been taken since the introduction of an independent competition authority in 2003.

Recommendations: Separate the ownership of fixed-telephony and cable networks to allow competition between them. The restructuring of the energy sector to increase competition should continue and be accompanied by appropriate measures to facilitate consumer switching. Reduce entry controls and licensing requirements in non-manufacturing sectors.

Reform employment protection legislation

Despite the 2003 labour law reform, employment protection regulations remain strict and procedures are cumbersome. This hampers labour mobility, reduces the creation of permanent jobs and slows the pace of adopting new technologies.

Actions taken: No further measures have been taken to reform the labour code.

Recommendations: Further ease employment protection legislation, particularly to facilitate individual dismissals, as this would be conducive to higher productivity growth and encourage hiring of regular workers.

Other key priorities

- Maintain the momentum of public administration reform to increase the efficiency of the public sector and facilitate the reallocation of labour to the private sector. The number of public employees should be allowed to fall. Employment conditions in the public sector should be aligned with private-sector rules to encourage mobility and an employee evaluation system should be introduced to link performance with career progression and pay.
- Simplify the tax system and broaden the corporate tax base, as the current system reduces productivity by imposing high compliance costs and encouraging inefficient informal activity. The tax system should be streamlined by reducing tax expenditures, and by making changes to the tax code less frequently.

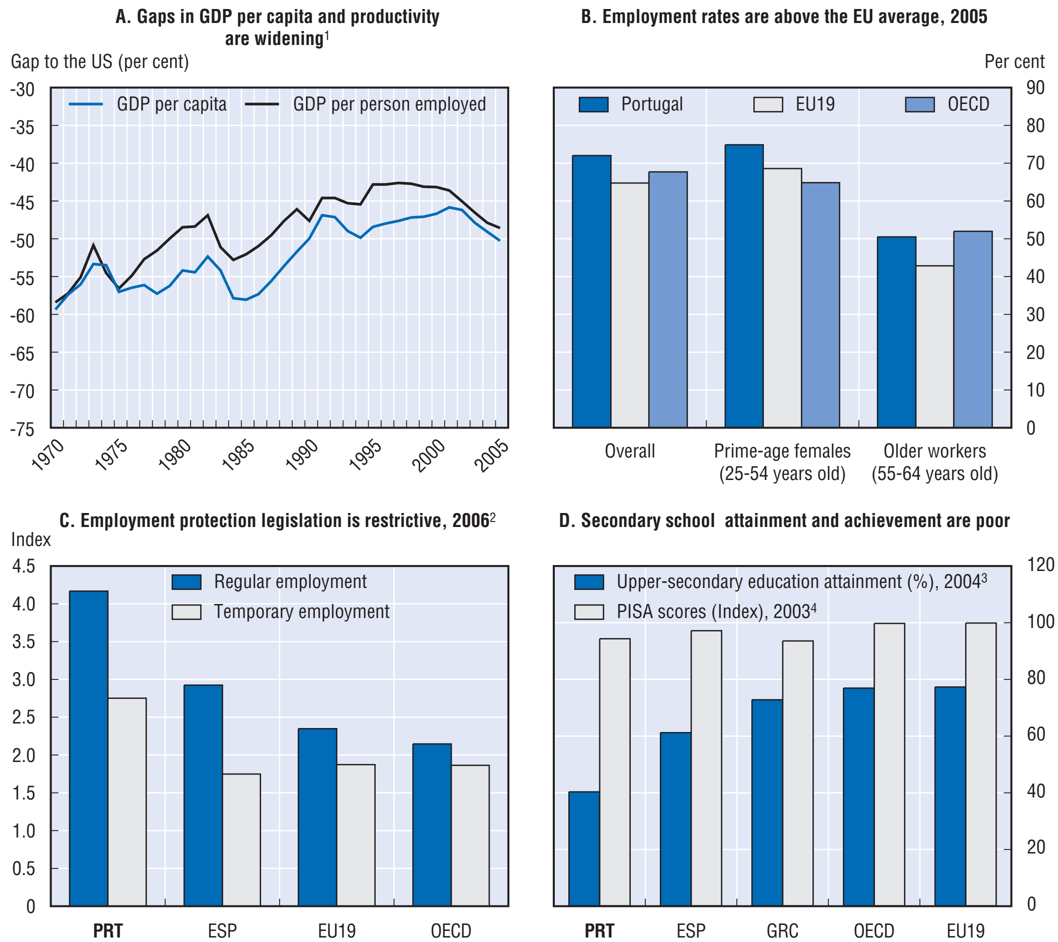
PORTUGAL

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	1.8	2.3	1.3
Labour utilisation	–0.1	0.0	–0.2
of which: Employment rate	0.4	0.6	0.2
Average hours	–0.5	–0.5	–0.4
Labour productivity	1.9	2.3	1.6
of which: Capital intensity	. .	. .	. .
Multifactor productivity	. .	. .	. .

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Indicator scale of 0-6 from least to most restrictive.
3. Percentage of population aged 25-34 that has attained at least upper-secondary education.
4. Average of mean scores in mathematics, science and reading. OECD = 100.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: *OECD Employment Outlook* (Chapter 2), 2004 and OECD calculations; Chart D: OECD, *Education at a Glance*, 2006 and OECD, PISA 2003 database.

StatLink: *http://dx.doi.org/10.1787/532416353370*

SLOVAK REPUBLIC

Notwithstanding significant convergence of GDP per capita vis-à-vis *the OECD average in recent years, substantial productivity and labour utilisation gaps remain.*

Priorities supported by indicators

Reduce the tax wedge for low-income workers

High employer social insurance contributions raise labour costs, lowering employment prospects especially for low-skilled workers and young people.

Actions taken: Little action has been taken recently to reduce the tax wedge for low-income earners. A reform of the pension system effective since 2004/5 tightened the relation between pension contributions and pension benefits, reducing labour supply disincentives from pension contributions for middle- and high-income earners.

Recommendations: Introduce an in-work benefit for low-income households with children, financed by cutting industrial and agricultural subsidies, while ensuring that the minimum wage, notably for youth, remains sufficiently low that it does not hamper employment prospects.

Improve funding and effectiveness of the education system

Test scores of 15-year-olds overall are below the OECD average and scores are strongly related to socio-economic background. Graduation rates from upper-secondary programmes are high but entry rates into university are below average. The unemployment incidence of vocational-school leavers is high.

Actions taken: New state examinations for final-year secondary-school students have been introduced. Teachers' salaries and spending on university teaching personnel have been raised.

Recommendations: Raise the pre-primary school education coverage of children aged between three and five. Provide additional funds per pupil to schools with a high proportion of groups at risk of under-achievement. Postpone the age at which pupils are selected into different tracks. Make vocational training more relevant for the labour market. Introduce university study fees accompanied by student loans with income-contingent repayments.

Reduce the implicit tax on continued work at older ages

Participation rates among older workers are low. The standard retirement age for men is 62 years and will reach 62 years for women in 2014. The implicit tax on continued work at older ages in the pay-as-you-go pension system is relatively high, creating incentives to retire early, notably for highly-skilled workers, who reach the minimum early retirement pension level more rapidly.

Actions taken: No change since the 2003 legislation introduced the funded pension pillar and set current retirement rules.

Recommendations: The retirement age should gradually be raised further in line with gains in life expectancy while making pension benefit adjustments for earlier and later retirement more actuarially neutral.

Other key priorities

- Reform housing markets to facilitate mobility, easing regulation of the private rental market, strengthening competition in construction and better targeting housing subsidies.
- Strengthen law enforcement. Improve accountability in the justice system by introducing performance indicators and disseminating court statistics. Make greater use of transparent and open procedures for public procurement.

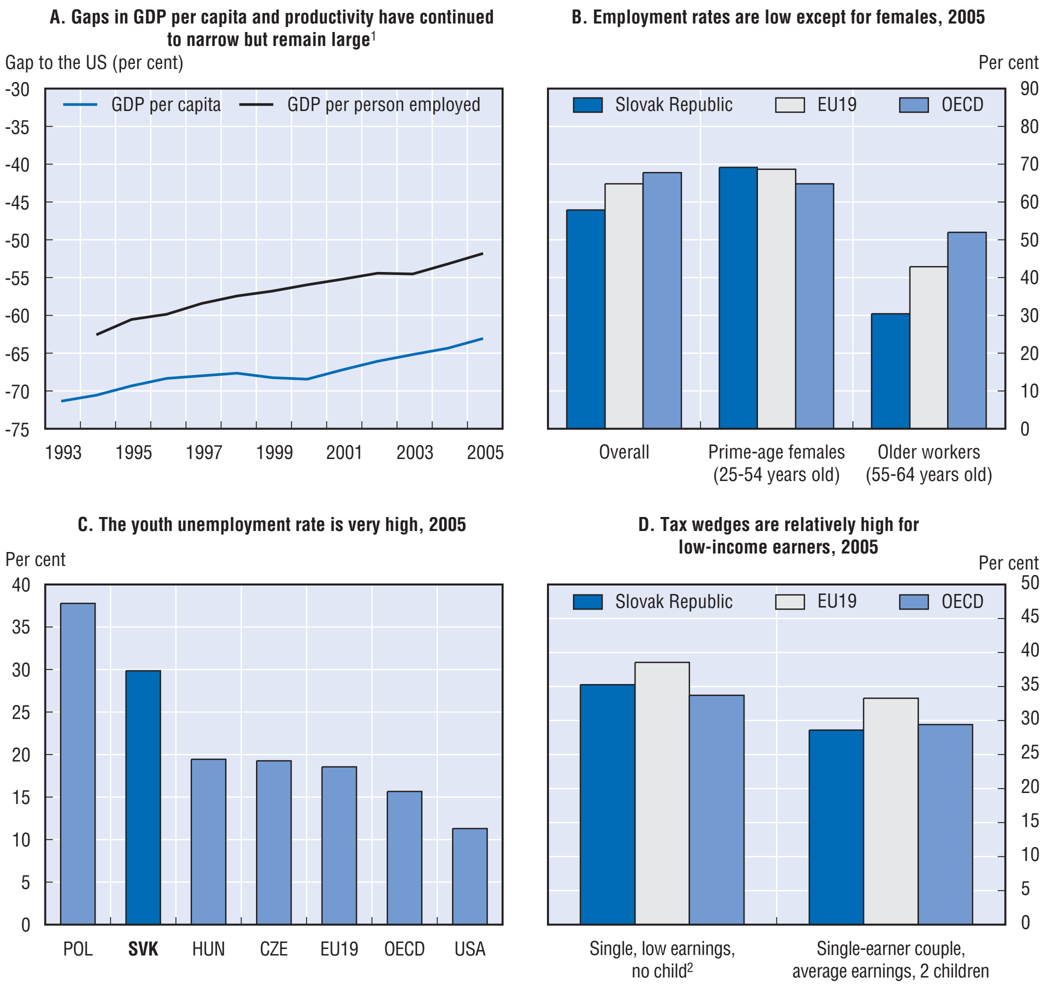
SLOVAK REPUBLIC

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	4.4	4.3	4.5
Labour utilisation	–0.1	0.0	–0.2
of which: Employment rate	0.6	0.6	0.5
Average hours	–0.7	–0.6	–0.8
Labour productivity	4.5	4.4	4.7
of which: Capital intensity	. .	. .	. .
Multifactor productivity	. .	. .	. .

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Low earnings refer to two-thirds of average earnings.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Charts B and C: OECD, *Labour Force Statistics*, 2006; Chart D: OECD, Taxing Wages database.

StatLink: *http://dx.doi.org/10.1787/532416353370*

SPAIN

Convergence vis-à-vis *best performing countries has continued in recent years, but substantial productivity and labour utilisation gaps remain.*

Priorities supported by indicators

Limit the extent of administrative extension of collective agreements

Wage negotiations are carried out mainly at the provincial and sectoral levels, and application of the resulting outcomes is made compulsory for all firms by administrative extension. This, coupled with the widespread use of indexation clauses, results in excessive wages for some groups in certain regions, with detrimental effects on their employment.

Actions taken: Social partners are having on-going discussions on this issue.

Recommendations: Allow firms to opt out of the application of provincial and sectoral wage agreements.

Reform employment protection legislation for regular workers

The high level of severance payments for permanent workers, especially compared with those of temporary workers, has created a segmented labour market with a negative effect on productivity growth and innovation.

Actions taken: The recent labour market reform contains restrictions on the successive use of temporary contracts, increases in fiscal support for the creation of jobs with permanent contracts and transitory incentives to convert temporary contracts into permanent ones.

Recommendations: Further reduce firing costs for workers with permanent contracts and promote a single contract in which required severance payments increase with the length of service. One option is to require employers to pay regular earnings-related contributions into individual severance accounts that can be accessed by the worker in the case of lay-off.

Strengthen competition in the retail distribution sector

Restrictions created by regional governments on the opening of new outlets impede competition in retail distribution, contributing to weak productivity gains and excessive profit margins in the sector.

Actions taken: The central government has adopted measures to increase the availability of information about prices and margins in the sector.

Recommendations: Eliminate the numerous barriers to the establishment of new hypermarkets and shopping centres put in place by regional governments, taking advantage of the new EU Services Directive which allows the central government to dismantle existing restrictions at the regional level.

Other key priorities

- In order to improve human capital formation, reform the higher education system by giving more independence to universities and making them more accountable for their results, which should be made easily available to teachers, students and employers.
- In order to reduce the incentives for some categories of workers to withdraw early from the labour force, raise the degree of actuarial fairness of the pension system by bringing lifetime contributions and benefits better into line.

SPAIN

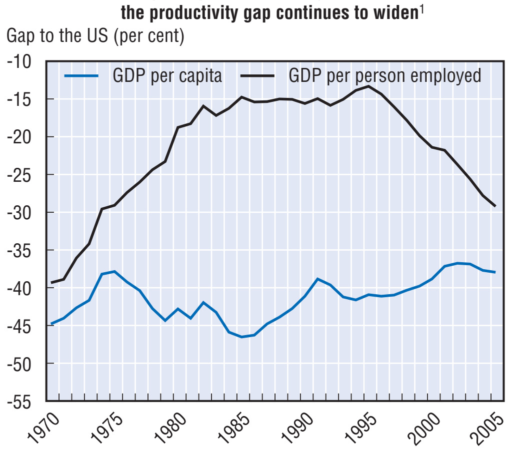
Structural indicators

Average annual trend growth rates, per cent

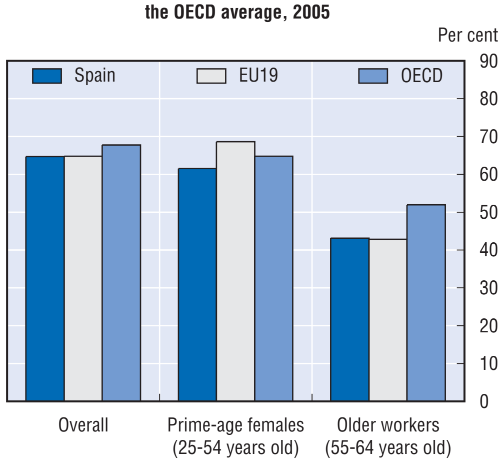
	1995-2005	1995-2000	2000-05
GDP per capita	2.5	3.0	1.9
Labour utilisation	1.7	2.1	1.3
of which: Employment rate	1.8	2.2	1.5
Average hours	–0.1	0.0	–0.2
Labour productivity	0.7	0.9	0.6
of which: Capital intensity	0.9	0.9	0.8
Multifactor productivity	–0.2	–0.1	–0.2

Source: Estimates based on *OECD Economic Outlook*, No. 80.

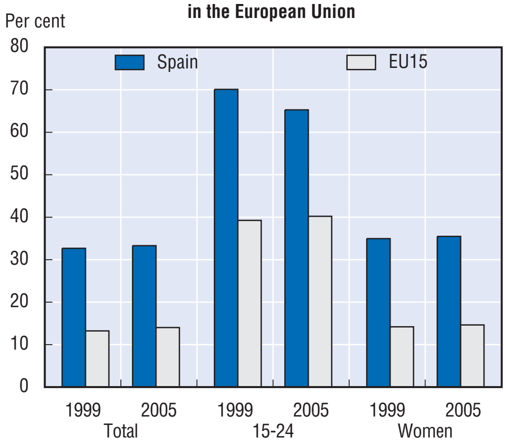
A. GDP per capita has converged somewhat but the productivity gap continues to widen[1]



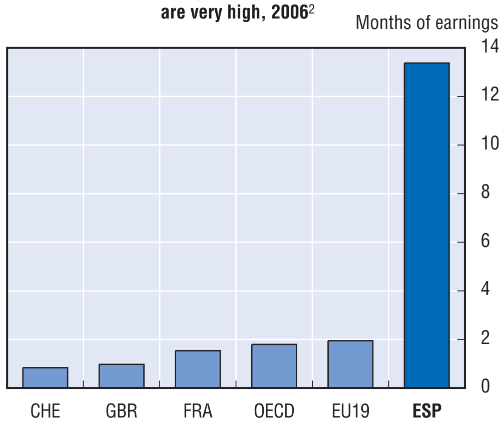
B. Employment rates remain below the OECD average, 2005



C. The share of temporary workers is among the highest in the European Union



D. Severance payments for regular workers are very high, 2006[2]



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Average severance pay after tenure of 9 months, 4 years and 20 years.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Charts B and C: OECD, *Labour Force Statistics*, 2006; Chart D: *OECD Employment Outlook* (Chapter 2), 2004 and OECD calculations.

StatLink: *http://dx.doi.org/10.1787/532416353370*

SWEDEN

Convergence of GDP per capita has resumed but gaps with the best performing countries remain, both with respect to labour utilisation and productivity.

Priorities supported by indicators

Reduce marginal taxes on labour income

Social security contributions and income taxes combine to a marginal rate above 60%, even for incomes modestly above average full-time earnings. As a result, incentives to increase working hours are weak.

Actions taken: An in-work tax credit worth over 1¼ per cent of GDP was introduced from January 2007, making work more rewarding relative to unemployment or inactivity. This also reduced marginal tax rates for low- and middle-income earners.

Recommendations: Bring down marginal income tax rates for above-average incomes by raising the threshold from where the state income tax is paid or reducing its rate. This could be financed by expenditure cuts, elimination of some tax exemptions and increasing real-estate taxes.

Reform sickness and disability benefit schemes

Sickness absence from work and the number of disability pensioners increased rapidly from the late 1990s. The numbers are now falling but remain among the highest in the OECD.

Actions taken: From 2007, the sickness benefit ceiling has been lowered and employers' contributions will be waived for hiring someone who has been out of work for more than a year, including when this has been due to sickness or disability. However, employers' co-financing of sickness benefits has been scaled back. Lay assessors will be abolished, assessment of diffuse symptoms improved and measures to combat over-use and fraud introduced.

Recommendations: Continue to improve administration in local social insurance offices, where implementation of tighter rules has not always been enforced. Introduce a time limit on receipt of disability benefits with subsequent renewal subject to re-assessment of rehabilitation options.

Reform employment protection legislation

Overly strict employment protection rules tend to preserve existing work organisational patterns by reducing staff turnover. Combined with administrative burdens and high taxes, such rules may also discourage people from leaving a safe job to start a new firm and hold back innovation.

Actions taken: Firms with fewer than ten employees have been exempted from certain elements of employment protection legislation and, from 2007, a new form of temporary contract is being introduced.

Recommendations: Reconsider those elements of employment protection legislation that are most likely to hinder business formation and flexibility.

Other key priorities

- Reduce the average age at which students begin tertiary education and speed up completion to raise the efficiency of the education system and increase the supply of skilled labour. Reform admission rules and phase out fiscal subsidies for overly-long course durations. Develop a system of tuition charging and loans for tertiary education to encourage completion.
- Reform housing policies to improve the allocation of resources and enhance labour mobility. Allow rents to be determined by market conditions, in particular for private rental housing. Increase competition in the construction sector and improve the land planning process.

SWEDEN

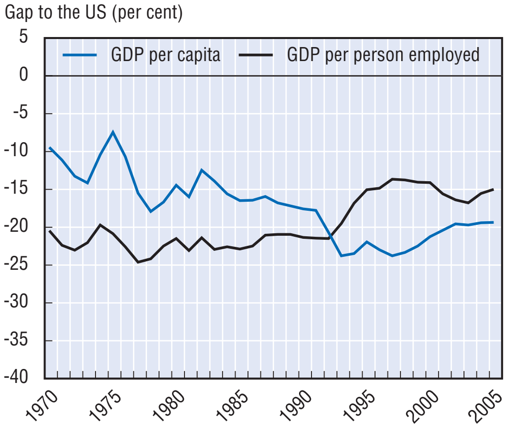
Structural indicators

Average annual trend growth rates, per cent

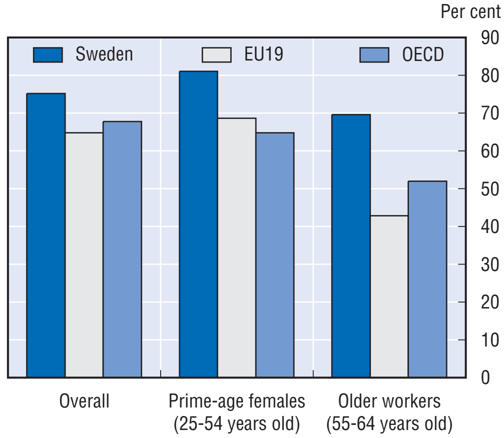
	1995-2005	1995-2000	2000-05
GDP per capita	2.1	2.0	2.3
Labour utilisation	–0.2	–0.4	0.1
of which: Employment rate	–0.2	–0.5	0.1
Average hours	0.0	0.1	–0.1
Labour productivity	2.3	2.4	2.2
of which: Capital intensity	1.0	1.2	0.7
Multifactor productivity	1.3	1.1	1.5

Source: Estimates based on *OECD Economic Outlook*, No. 80.

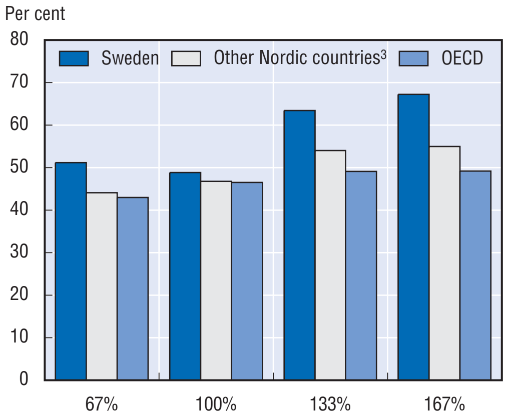
A. GDP per capita has converged but productivity has stalled[1]



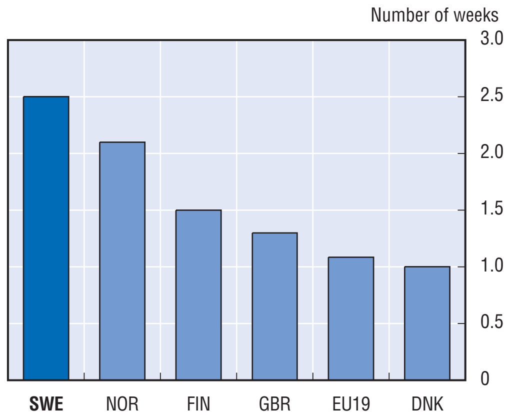
B. Employment rates are high, 2005



C. Marginal tax wedges are high, 2005[2]



D. The average number of weeks lost per employee due to sickness is the highest in OECD, 2004



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Evaluated at 67%, 100%, 133% and 167% of average earnings.
3. Average of Denmark, Finland, Iceland and Norway.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Taxing Wages database; Chart D: *OECD Employment Outlook* (Chapter 1), 2004 and OECD calculations.

StatLink: *http://dx.doi.org/10.1787/532416353370*

SWITZERLAND

While Switzerland is still a prosperous country, growth of income per capita has been weak and considerably below the OECD average for a number of years, essentially because of lacklustre productivity gains.

Priorities supported by indicators

Further reduce barriers to competition in network industries

Network industries have been only partially liberalised, with uneven progress across sectors and at a slower pace than the reform process underway in the European Union.

Actions taken: In telecommunications, the unbundling of the local loop has been decided, even though it will be only temporary for some services. In electricity, a reform package, which provides for a progressive opening of the market in a way compatible with EU rules, is being examined by parliament. A draft reform aiming at a complete liberalisation of postal services is being prepared.

Recommendations: Accelerate the liberalisation process, in particular in the electricity, gas and postal sectors, including by removing barriers to entry so as to bring efficiency gains and lower prices. In telecommunications, extend the unbundling of the local loop on a permanent basis.

Reduce producer support to agriculture

In 2005, the level of producer support represented just under 70% of farm receipts, which is over two times the OECD average. A lack of foreign competition has led to higher food prices than abroad and the maintenance of resources in low-productivity activities.

Actions taken: Support has shifted to more market-friendly instruments, even though progress in this respect remains slow. Milk quotas are set to be abolished by 2009.

Recommendations: Accelerate the reduction of producer support to agriculture and de-link subsidies from production.

Facilitate full-time labour force participation for women

Hours worked by women remain low in international comparison because of the prevalence of part-time jobs which reflect strong disincentives to participate more actively in the labour force.

Actions taken: A reform to remove the existing tax disincentives for married women to work was adopted in autumn 2006 and will be implemented as of 2008.

Recommendations: Action is required at all levels of government to develop affordable full-time care for both very young and school-age children.

Other key priorities

- Technical regulations deviating from those of EU members in areas such as production, packaging and labelling, which make imported products more expensive, should be reduced by accepting products conforming to EU standards (the "Cassis de Dijon" principle).
- Health system costs should be contained through better regulations, in particular by abolishing the requirement of insurers to contract with all health care providers so as to enhance the scope for differentiating fees across healthcare providers and to better control medical interventions. Effective competition would also be stimulated by removing barriers created by the canton-based organisation of both health supply and the insurance system.

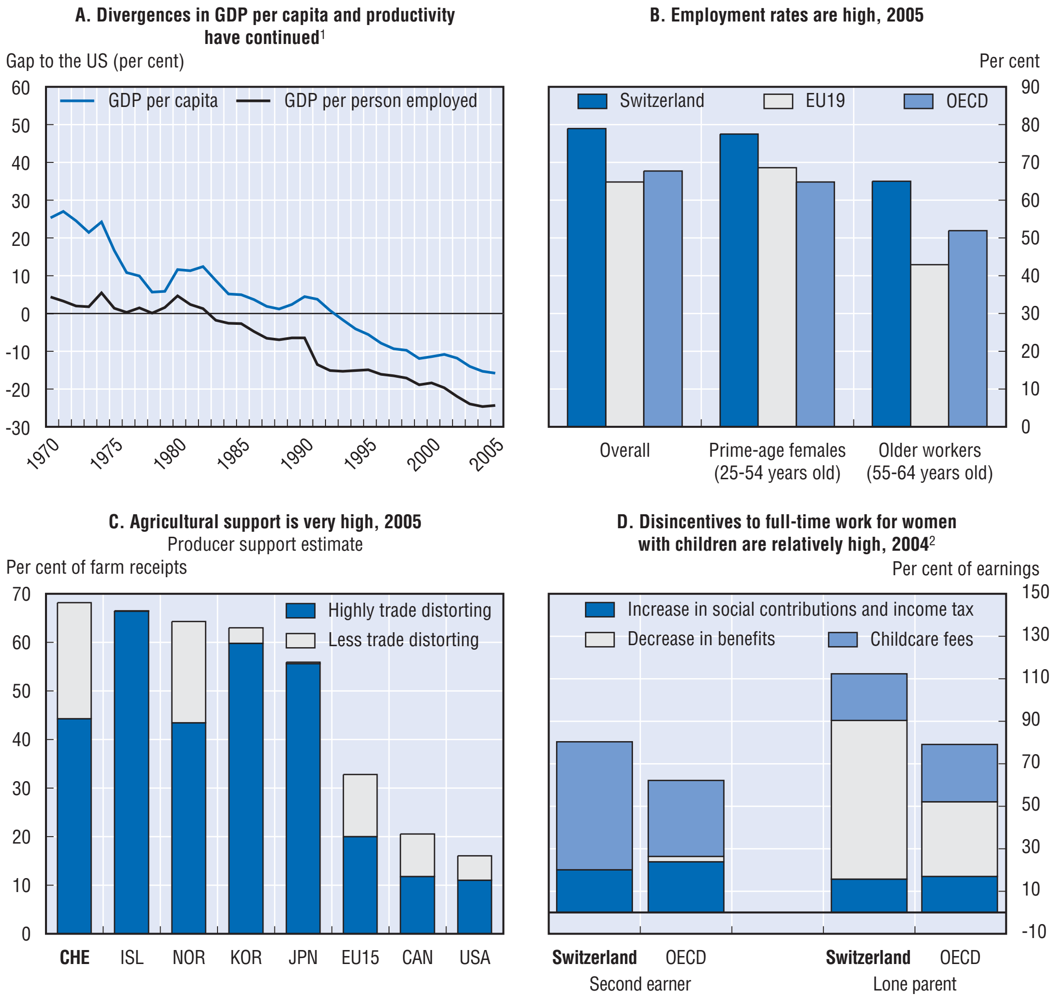
SWITZERLAND

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	0.9	0.9	0.8
Labour utilisation	–0.2	–0.4	0.0
of which: Employment rate	0.0	–0.1	0.1
Average hours	–0.3	–0.3	–0.2
Labour productivity	1.1	1.3	0.9
of which: Capital intensity	0.8	1.0	0.5
Multifactor productivity	0.3	0.3	0.4

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 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 parents with income equal to two-thirds of average earnings.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Producer and Consumer Support Estimates database; Chart D: OECD, *Benefits and Wages: OECD Indicators*, 2007, forthcoming.

StatLink: *http://dx.doi.org/10.1787/532416353370*

TURKEY

Despite a recent growth pick-up, GDP per capita remains well below the OECD average. Productivity is very low and labour utilisation is weak.

Priorities supported by indicators

Reduce the minimum cost of labour

A high minimum wage relative to the median wage and high payroll taxes keep minimum employment costs very high in the formal sector. This discourages the employment of low-skilled workers in the formal sector, particularly in regions where labour productivity is low.

Actions taken: No action has been taken to reduce the minimum cost of labour.

Recommendations: Substantially reduce payroll taxes and finance this with a package of other reforms, including a reduction in early retirement incentives. Slow the rate of increase of the minimum wage and differentiate it across regions.

Reform employment protection legislation

Employment protection is rigid for both permanent and temporary workers, contributing to maintaining resources in inefficient informal activities.

Actions taken: No action taken recently.

Recommendations: Reduce the distortionary effect of employment protection regulation by lowering the level of severance payments for dismissed permanent workers and easing restrictions in the case of temporary workers.

Improve access to, and quality of, primary and secondary education

The average academic performance of the education system is very low. The lack of basic skills for a large share of the population results in low productivity and hampers growth.

Actions taken: Curriculum reforms in 2005 aimed at increasing the quality of primary and secondary education.

Recommendations: To ensure that the entire youth population receives a good education, increase spending on education when aggregate fiscal constraints permit. Schools should be funded on a per-pupil basis and be provided with greater managerial responsibility and accountability.

Other key priorities

- To improve productivity performance, simplify product market regulations, in particular the sectoral licensing rules which hinder market entry, and encourage greater competition in network industries.
- To strengthen labour utilisation, reduce early retirement incentives for workers in the formal sector by lowering net pension benefits and removing retiring workers' entitlement to severance payments.

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TURKEY

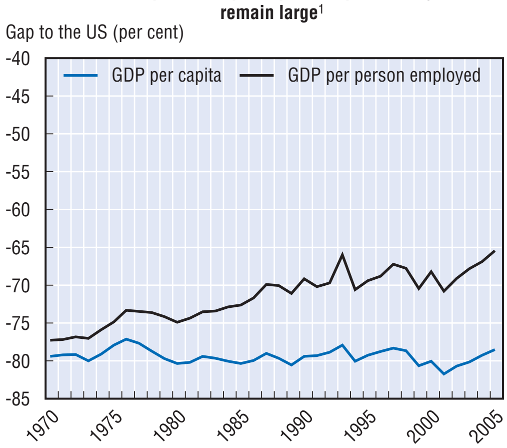
Structural indicators

Average annual trend growth rates, per cent

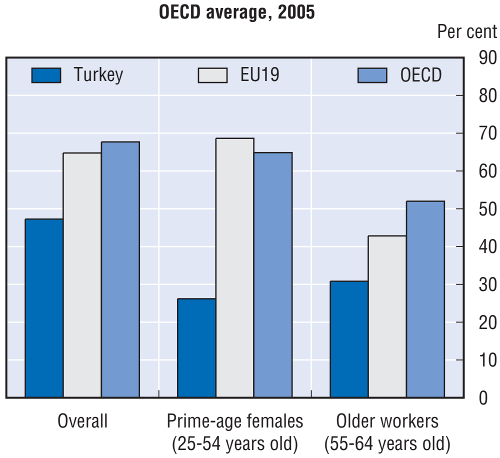
	1995-2004	1995-2000	2000-04
GDP per capita	2.3	1.9	2.8
Labour utilisation	–0.1	–0.1	0.1
of which: Employment rate	–0.1	–0.3	0.1
Average hours	0.0	0.1	–0.1
Labour productivity	2.4	2.1	2.8
of which: Capital intensity	. .	. .	. .
Multifactor productivity	. .	. .	. .

Source: Estimates based on *OECD Economic Outlook*, No. 80.

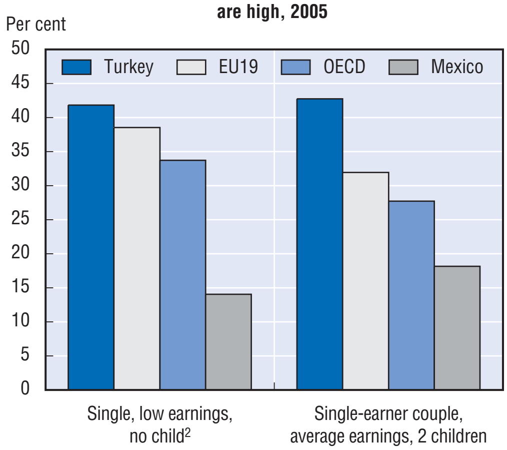
A. Gaps in GDP per capita and productivity remain large[1]



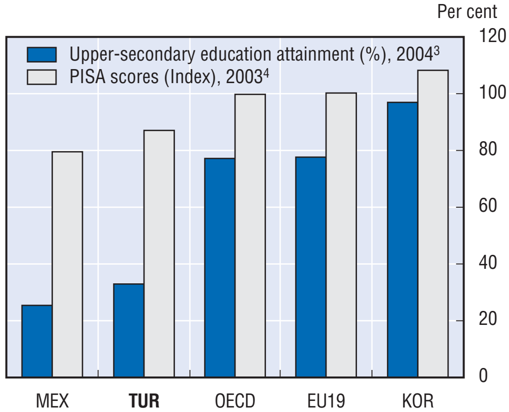
B. Employment rates are well below OECD average, 2005



C. Tax wedges for low- and middle-income earners are high, 2005



D. Secondary school attainment and achievement are poor



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).
2. Low earnings refer to two-thirds of average earnings.
3. Percentage of population aged 25-34 that has attained at least upper-secondary education.
4. Average mean scores in mathematics, science and reading. OECD = 100.

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, Taxing Wages database; Chart D: OECD, *Education at a Glance*, 2006 and OECD, PISA 2003 database.

StatLink: *http://dx.doi.org/10.1787/532416353370*

UNITED KINGDOM

Convergence of GDP per capita has resumed and employment rates are high, but the productivity gap vis-à-vis *the best performing countries is wide.*

Priorities supported by indicators

Further reform disability benefit schemes

The number of disability-related benefit recipients has grown faster than in most other OECD countries, particularly among prime-age men.

Actions taken: The coverage of the mandatory interview-based process to access back-to-work programmes and benefits (Pathways to Work) was extended to a third of new claimants in 2006. The scheme will be offered to all existing claimants on a voluntary basis by 2008. A welfare reform proposal is being considered that aims to replace the incapacity benefit by a disability employment allowance, improve medical assessments and further strengthen incentives to participate in the Pathways to Work programme.

Recommendations: Continue to extend the Pathways to Work scheme to cover all new claimants as planned and make sure that the implementation is effective. Extend the scheme on a mandatory basis to the stock of existing claimants if the pilots are successful. Improve the monitoring of the health status of people reaching the end of entitlement to sickness pay and benefits, and make the medical assessment of disability claims earlier.

Improve the education achievement of young people

A large share of students leaves school before completion of upper-secondary education and thus without a specific competence in a professional field, while a large share of the adult workforce has a low level of skills.

Actions taken: An updating of vocational diplomas and a pilot scheme to help young people back into education have been introduced. Training programmes for adults with low skills are being created.

Recommendations: Continue to emphasise the acquisition of core literacy and numeracy skills for pupils at all age-levels, so as to improve prospects for further education achievement beyond lower secondary school. Work with universities to establish clearly how the skills and competencies acquired via the new vocational diplomas compare with those obtained from following a more traditional academic path.

Improve public infrastructure, especially for transportation

Under-investment in public infrastructure has resulted in road congestion and an unreliable rail system, which add to business costs and constrain productivity.

Actions taken: An increase of transportation spending above that allocated in the Ten Year Plan has been announced. A special government-appointed group (Eddington Study) has assessed long-term business infrastructure and transportation needs and argued in favour of extending road pricing.

Recommendations: Maintain investment in infrastructure at least at levels envisaged in current spending plans. Continue with preparations for a national road pricing scheme.

Other key priorities

- Lower marginal effective tax rates for lone parents in low-paid, part-time jobs so as to raise their incentives to work longer hours or to up-skill. Also, reduce child-care costs to encourage labour force participation of low-skilled second earners.
- Improve the efficiency of health and other publicly-funded services by strengthening incentives to achieve performance targets. Ensure that higher expenditure results in higher standards of service delivery.

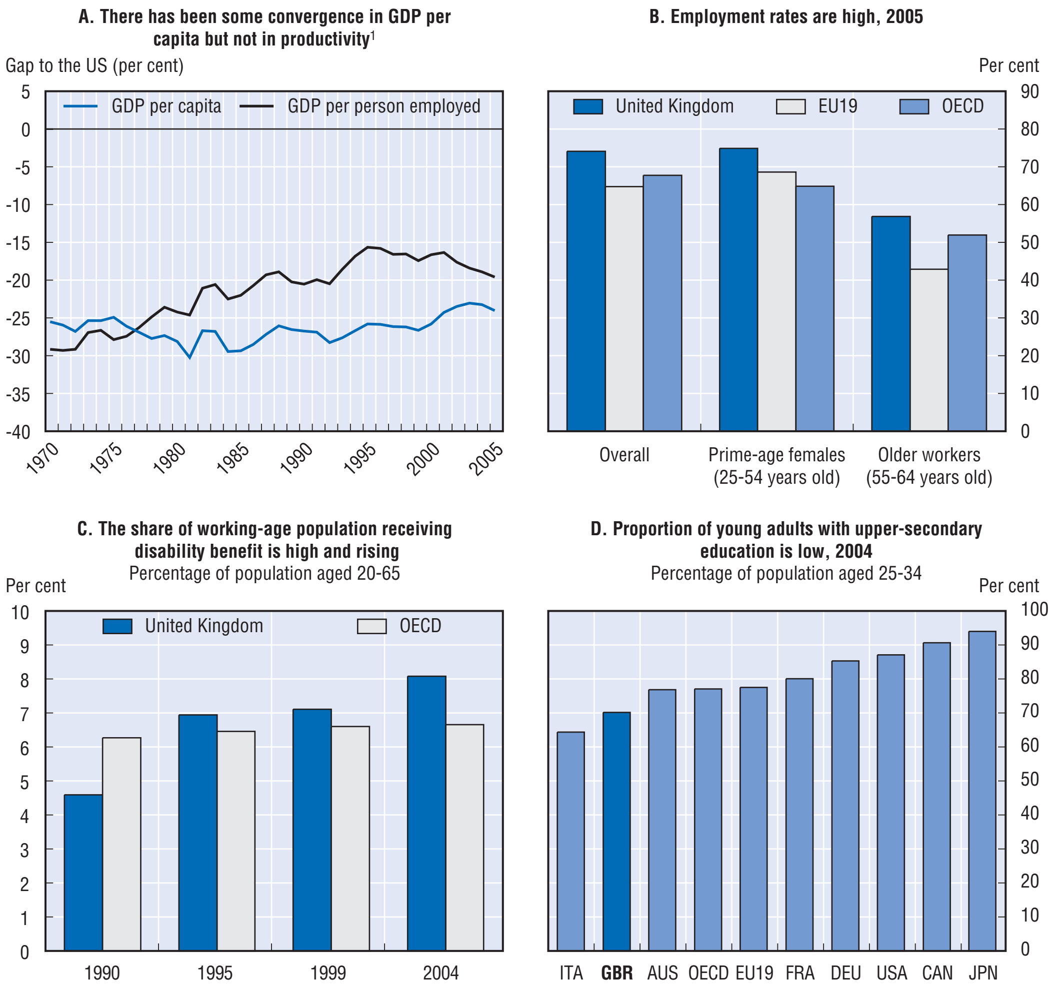
UNITED KINGDOM

Structural indicators

Average annual trend growth rates, per cent

	1995-2005	1995-2000	2000-05
GDP per capita	2.3	2.4	2.2
Labour utilisation	0.1	0.2	0.1
of which: Employment rate	0.5	0.5	0.4
Average hours	–0.4	–0.4	–0.4
Labour productivity	2.2	2.3	2.1
of which: Capital intensity	0.9	1.0	0.8
Multifactor productivity	1.3	1.3	1.3

Source: Estimates based on *OECD Economic Outlook*, No. 80.



1. Percentage gap with respect to US GDP per capita and per person employed (in constant 2000 PPPs).

Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, *Transforming Disability into Ability*, 2003 and OECD calculations; Chart D: OECD, *Education at a Glance*, 2006.

StatLink: *http://dx.doi.org/10.1787/532416353370*

UNITED STATES

Labour productivity has accelerated since the mid-1990s from an already high level and labour utilisation is strong. Nevertheless, further efficiency gains can be achieved in several areas.

Priorities supported by indicators

Improve educational achievements at the primary and secondary levels

The outcomes of compulsory education are poor despite much higher spending per pupil than in most other OECD countries, constraining productivity gains.

Actions taken: The 2002 "No Child Left Behind" Act provided for testing, greater accountability, increased choice and additional federal funding for schools in lower-income areas.

Recommendations: Continue the "No Child Left Behind" reforms, in particular greater accountability, and facilitating choice when schools under-perform. Pressures on states to lower performance standards should be resisted.

Restrain health care costs

Health expenditures account for a much larger share of national income than in other OECD countries, but US health outcomes are not noticeably better and many Americans lack health insurance. High insurance premia may inflate labour costs, with an adverse impact on labour market performance.

Actions taken: Medicare prescription drug coverage was extended to all seniors in 2006 (with cost-saving measures being implemented only gradually). The Administration has proposed extending Health Savings Accounts to reduce distortions that encourage over-consumption of health services.

Recommendations: Limit the current open-ended tax-deductibility of health insurance premiums. Medicare reform should focus on reducing cost per enrolee to ensure long-term solvency.

Reduce producer support to agriculture

Support for agriculture has been stable over recent years and is below the OECD average. However, it remains highly distortionary and maintains excessive resources in low productivity activities.

Actions taken: Support for tobacco producers was made more market-oriented in 2005, but the distortionary dairy programme was extended.

Recommendations: Reduce support for agricultural producers and not tie it to specific inputs or outputs.

Other key priorities

- Reduce the efficiency cost of taxation by broadening the tax base and move from personal income taxation towards a consumption-based tax system, *inter alia*, by raising current low taxes on carbon-based energy consumption, which would in addition improve environmental outcomes.
- The disincentive effects of the disability insurance system have been increasing because of declining relative wages for unskilled labour and the rising real value of medical benefits, locking an increasing share of the population out of the labour force. These unintended developments should be reversed and eligibility criteria tightened.

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UNITED STATES

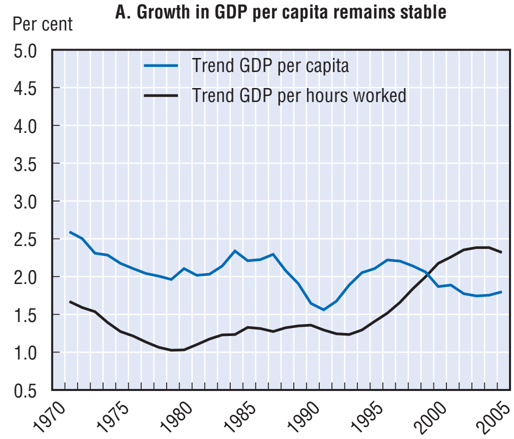
Structural indicators

Average annual trend growth rates, per cent

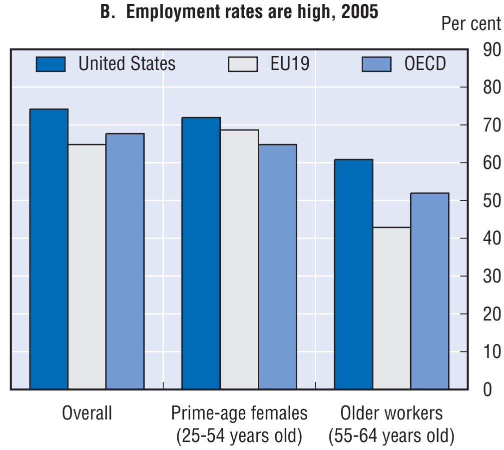
	1995-2005	1995-2000	2000-05
GDP per capita	1.9	2.1	1.8
Labour utilisation	–0.1	0.3	–0.5
of which: Employment rate	0.0	0.3	–0.3
Average hours	–0.1	0.0	–0.3
Labour productivity	2.1	1.8	2.3
of which: Capital intensity	1.2	1.1	1.2
Multifactor productivity	0.9	0.7	1.1

Source: Estimates based on *OECD Economic Outlook*, No. 80.

A. Growth in GDP per capita remains stable

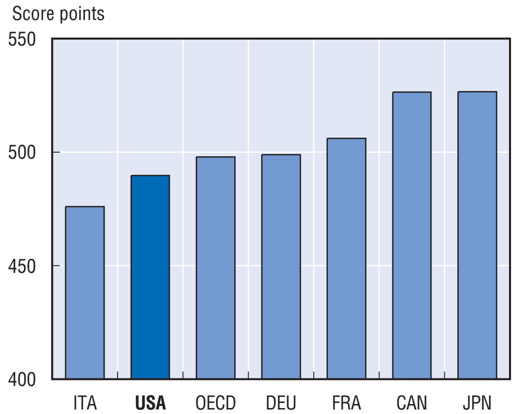


B. Employment rates are high, 2005

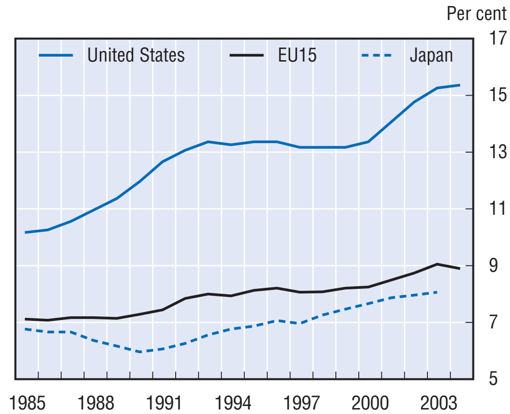


C. Education performance is poor at the compulsory level

Average mean scores in mathematics, science and reading, 2003



D. Health spending is absorbing a rising share of GDP



Source: Chart A: OECD, *National Accounts of OECD Countries*, 2006; Chart B: OECD, *Labour Force Statistics*, 2006; Chart C: OECD, PISA 2003 database and OECD, *Education at a Glance*, 2006; Chart D: OECD, *Health Data 2006: Statistics and Indicators for 30 Countries.*

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Economic Policy Reforms
Going for Growth

PART I

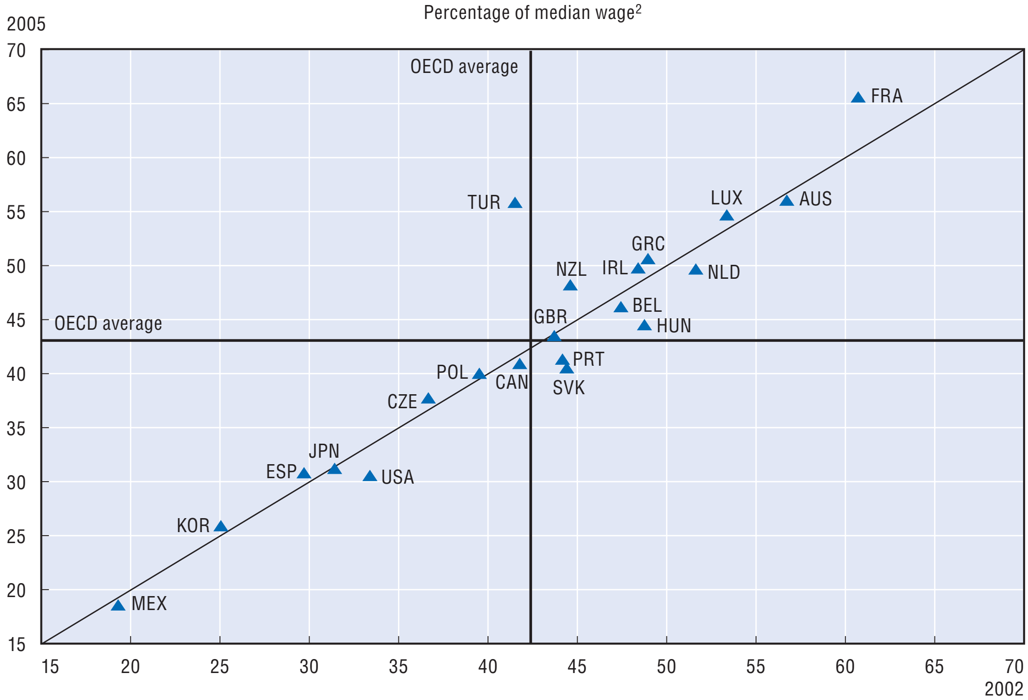
Chapter 3

Structural Policy Indicators

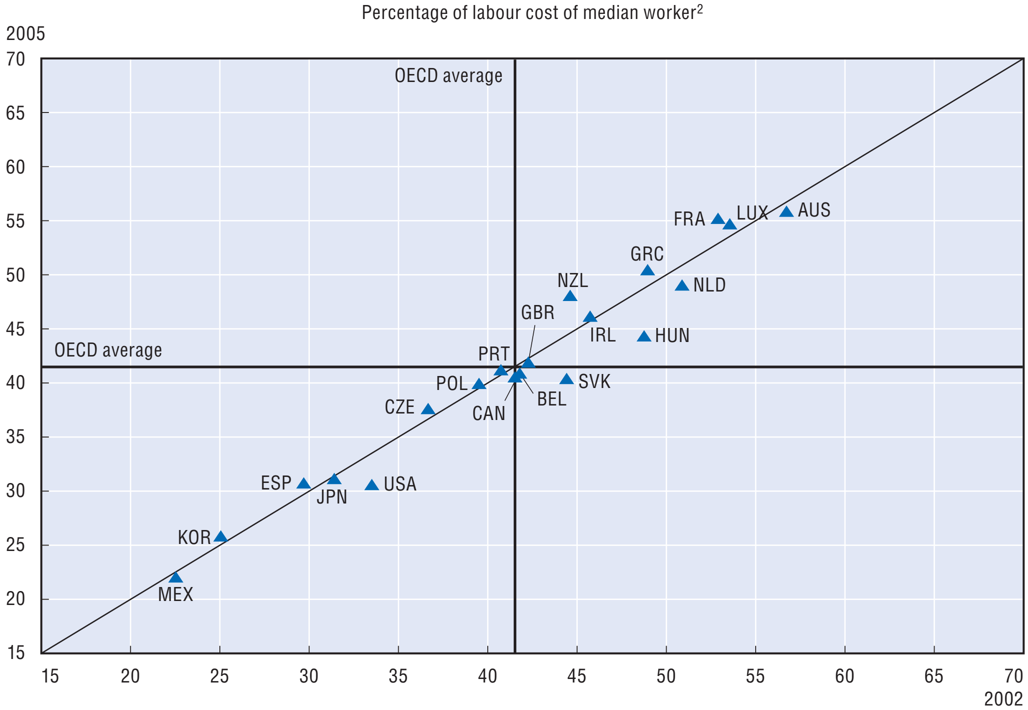
This chapter contains comparative OECD indicators for labour costs and labour taxation; unemployment, disability and sickness income support; labour market and product market regulation; barriers to competition, trade and investment, sectoral regulation, educational attainment and achievement; health expenditure; and public investment. These indicators have been used to identify the policy priorities that are discussed in this report.

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]



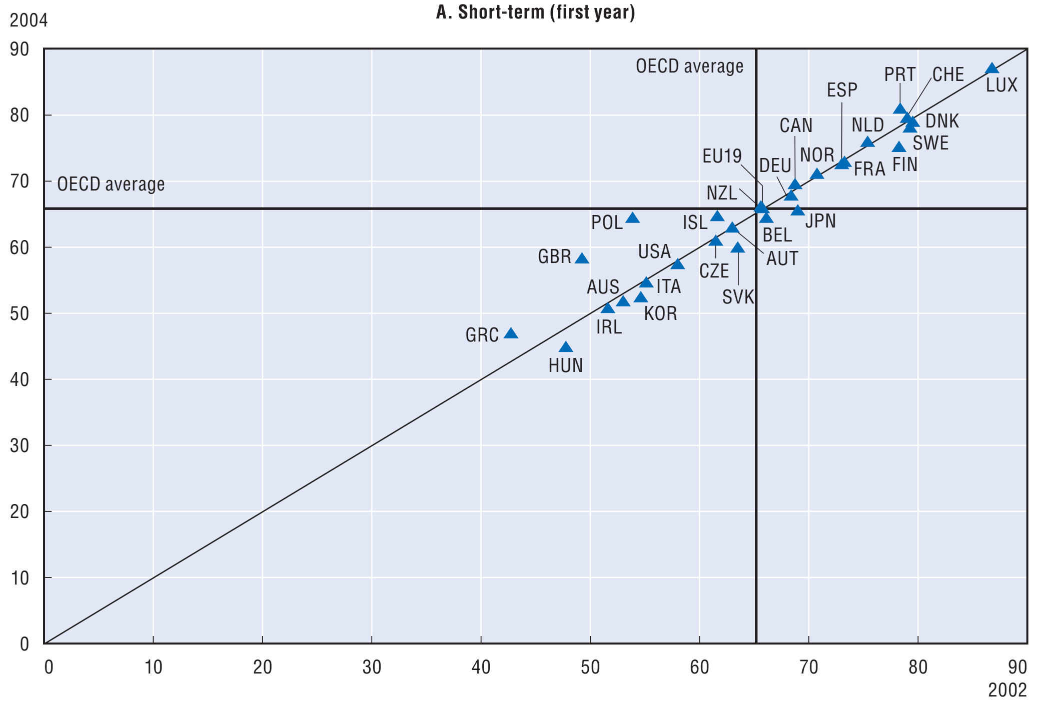
1. Missing countries do not have statutory mininum wage.
2. Exactly half of all workers have wages either below or above the median wage.
3. The cost of labour is the sum of the wage level and the corresponding social security contribution paid by employers.

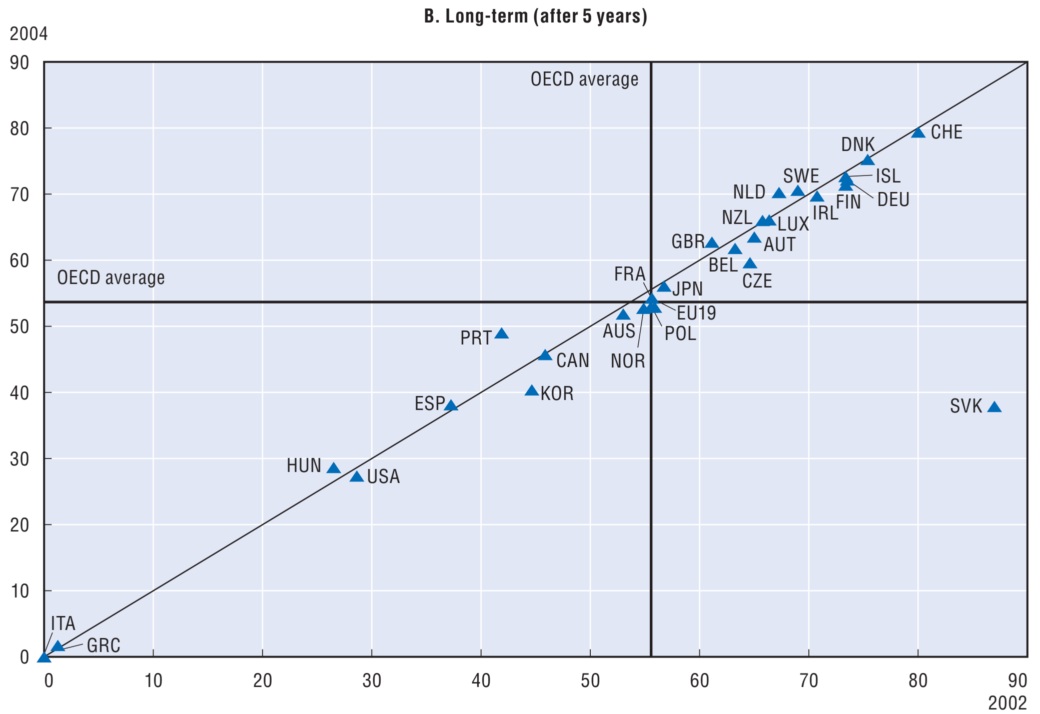
Source: Chart A: OECD, *Labour Force Statistics*, 2006; Chart B: *OECD Employment Outlook*, 2006 and OECD, Taxing Wages database.

StatLink: *http://dx.doi.org/10.1787/531254872686*

Figure 3.2. **Net income replacement rates for unemployment**[1]

Percentage of earnings





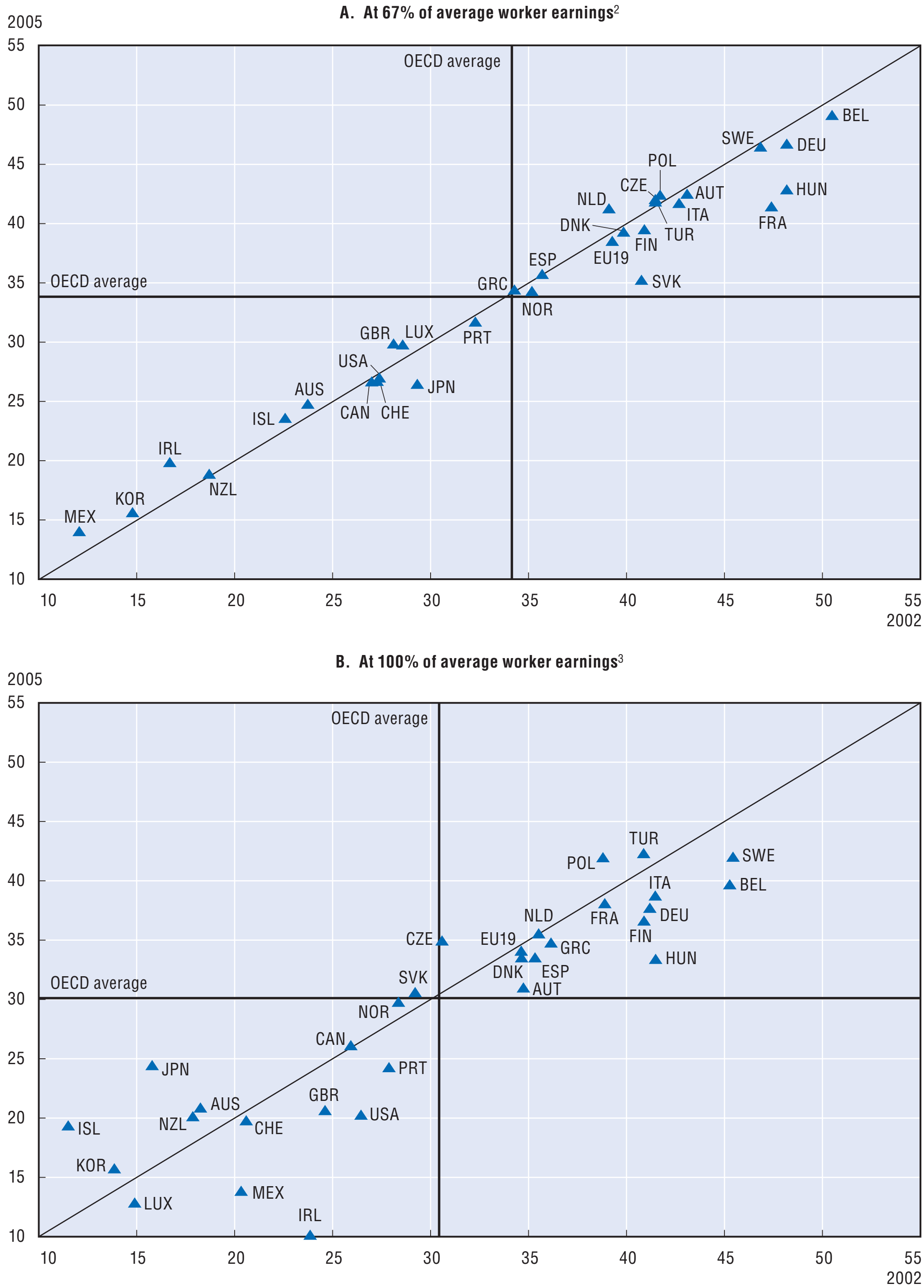
1. Average of replacement rates for unemployed who earned 67 % and 100 % of average worker earnings at the time of losing job.

Source: OECD, Benefits and Wages database.

StatLink: *http://dx.doi.org/10.1787/715627724205*

Figure 3.3. **Average tax wedge on labour**[1]

Percentage of total labour compensation



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. Single person with no child.
3. Couple with 2 children, average of three situations regarding the earnings of the second earner.

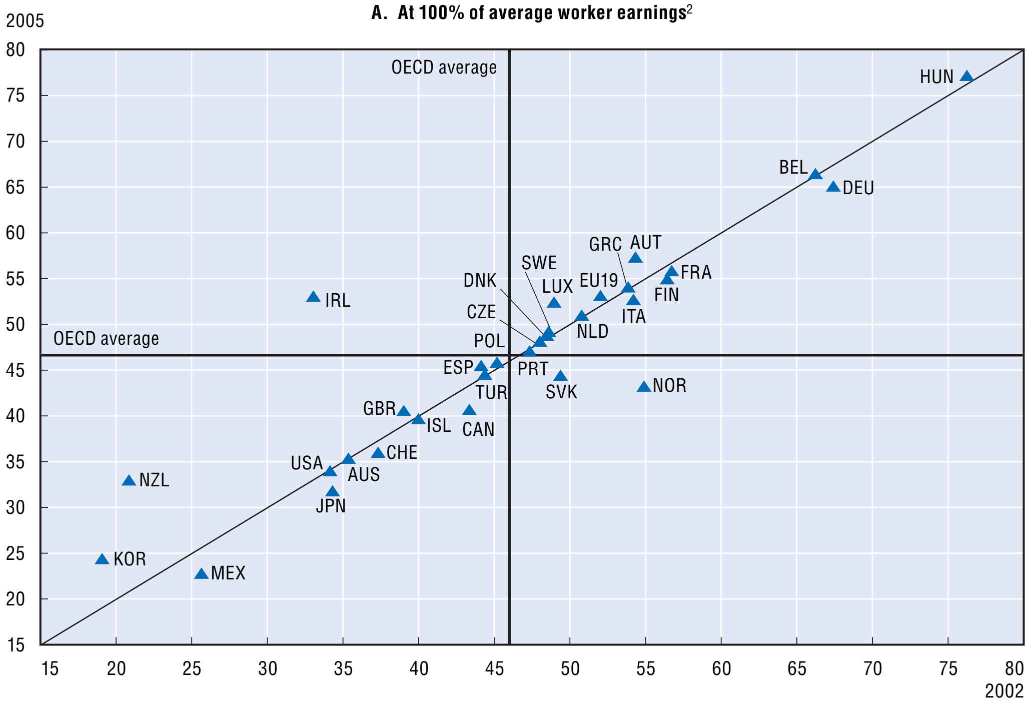
Source: OECD, Taxing Wages database.

StatLink: *http://dx.doi.org/10.1787/224261242434*

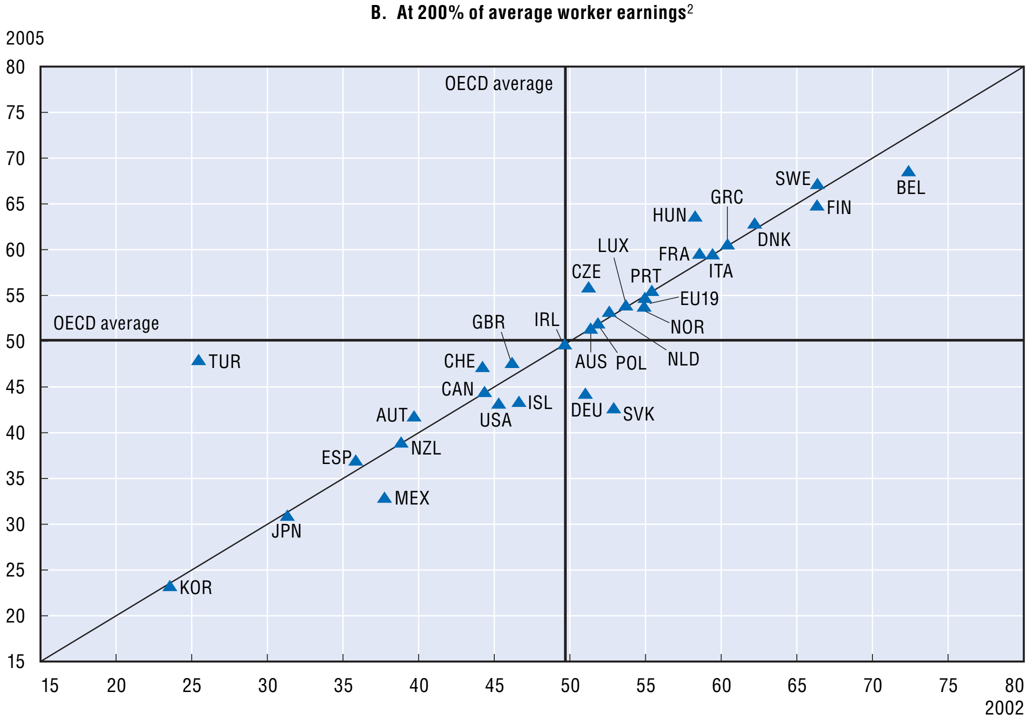
Figure 3.4. **Marginal tax wedge on labour**[1]

Percentage of total labour compensation

A. At 100% of average worker earnings[2]



B. At 200% of average worker earnings[2]



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.
2. Single person with no child.

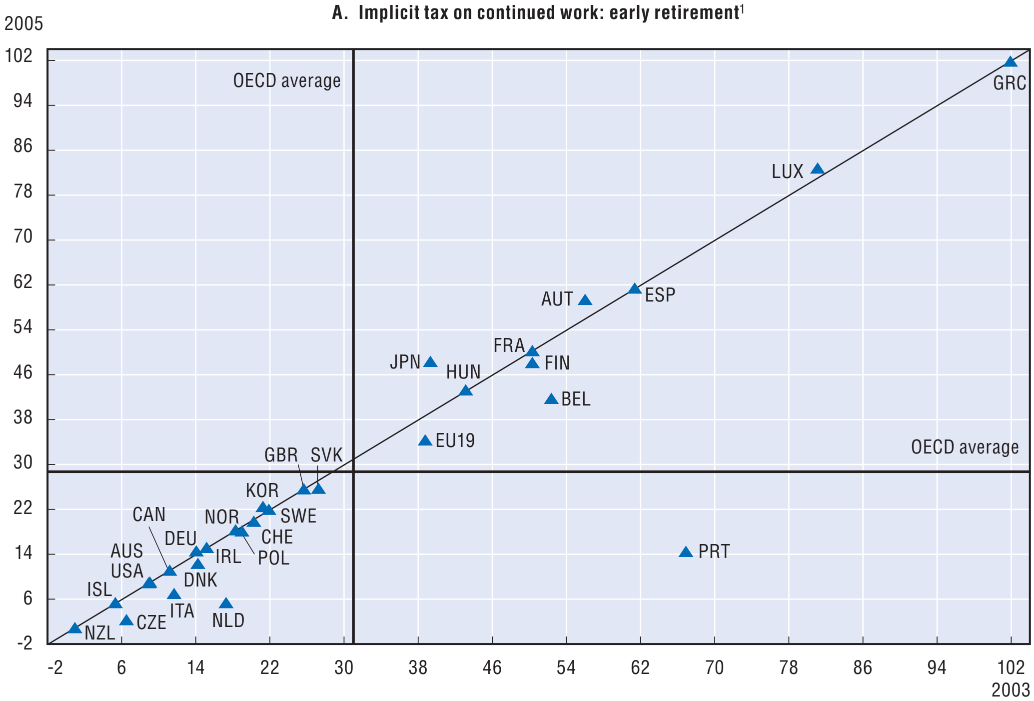
Source: OECD, Taxing Wages database.

StatLink: *http://dx.doi.org/10.1787/008025538404*

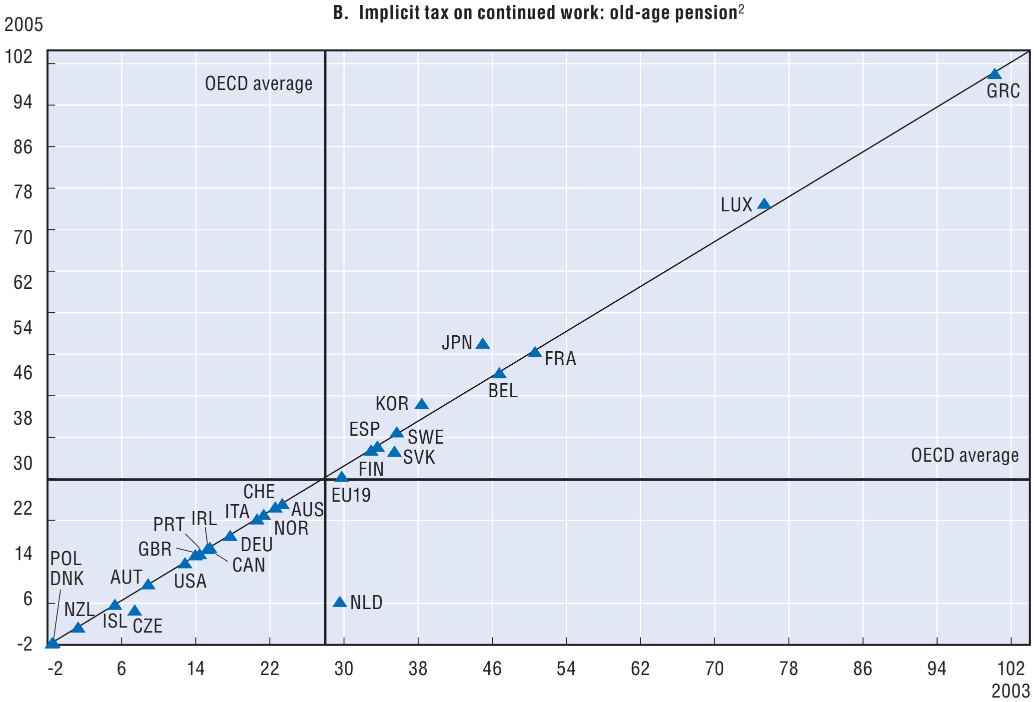
Figure 3.5. **Labour taxation**

Percentage of average worker earnings

A. Implicit tax on continued work: early retirement[1]



B. Implicit tax on continued work: old-age pension[2]

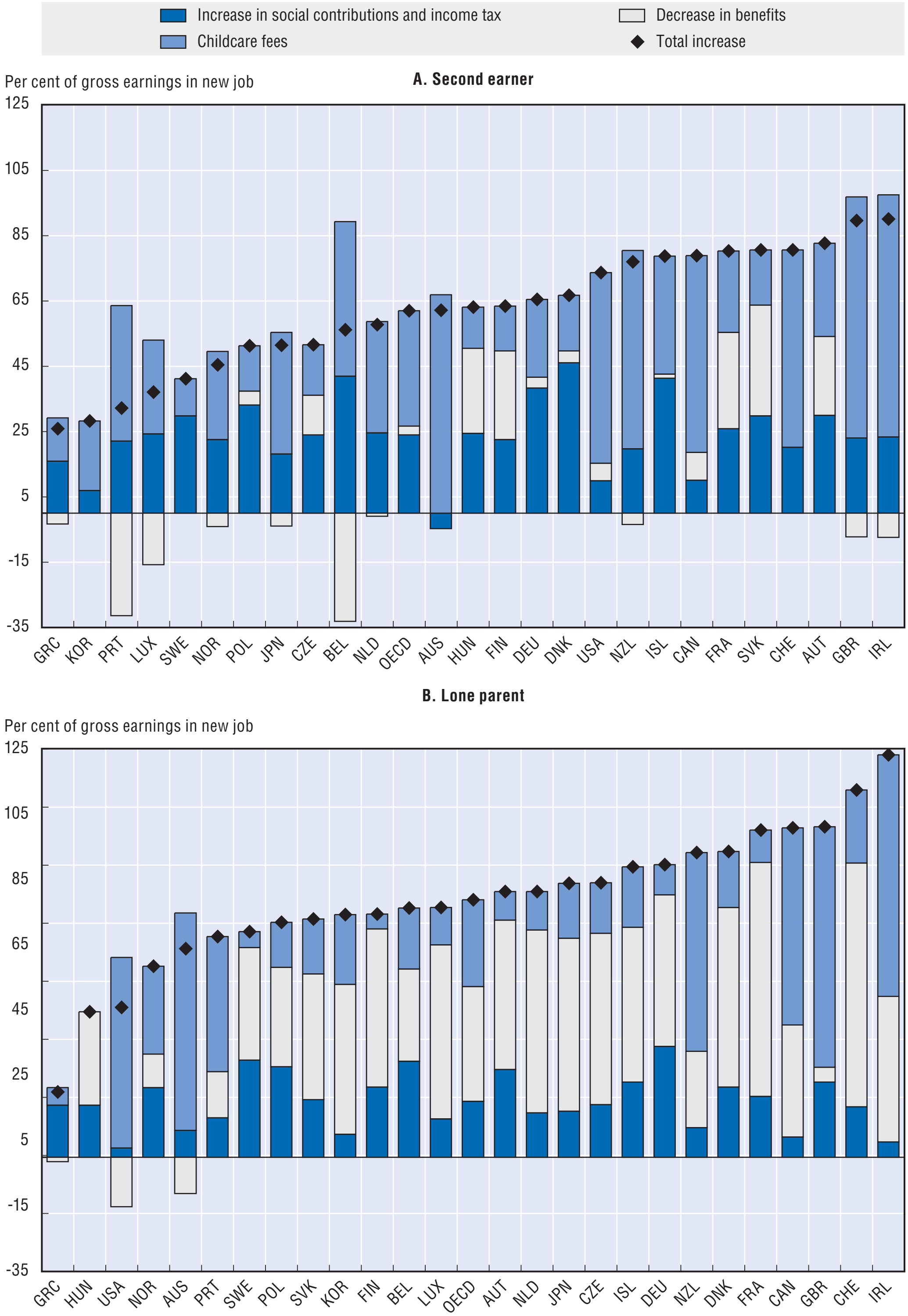


1. Average of implicit tax on continued work in early retirement route, for 55- and 60-year-olds.
2. Implicit tax on continued work in regular old-age pension systems, for 60-year-olds.

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.

StatLink: *http://dx.doi.org/10.1787/600642677431*

Figure 3.6. **Implicit tax on returning to work, 2004**[1]



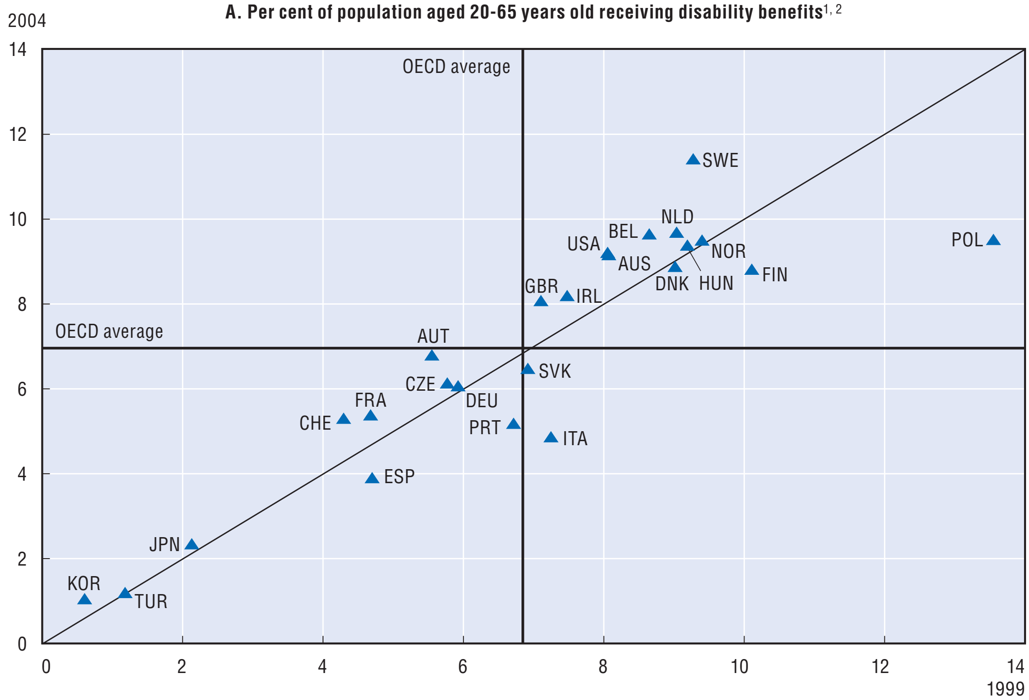
1. Taking into account childcare fees and changes of taxes and benefits in case of a transition to a job paying two-thirds of average worker earnings.

Source: OECD, *Benefits and Wages: OECD Indicators*, 2007, forthcoming.

StatLink: *http://dx.doi.org/10.1787/178038881238*

Figure 3.7. **Income support for disability and sickness**

A. Per cent of population aged 20-65 years old receiving disability benefits[1, 2]



B. Number of weeks lost due to sickness leave[2]

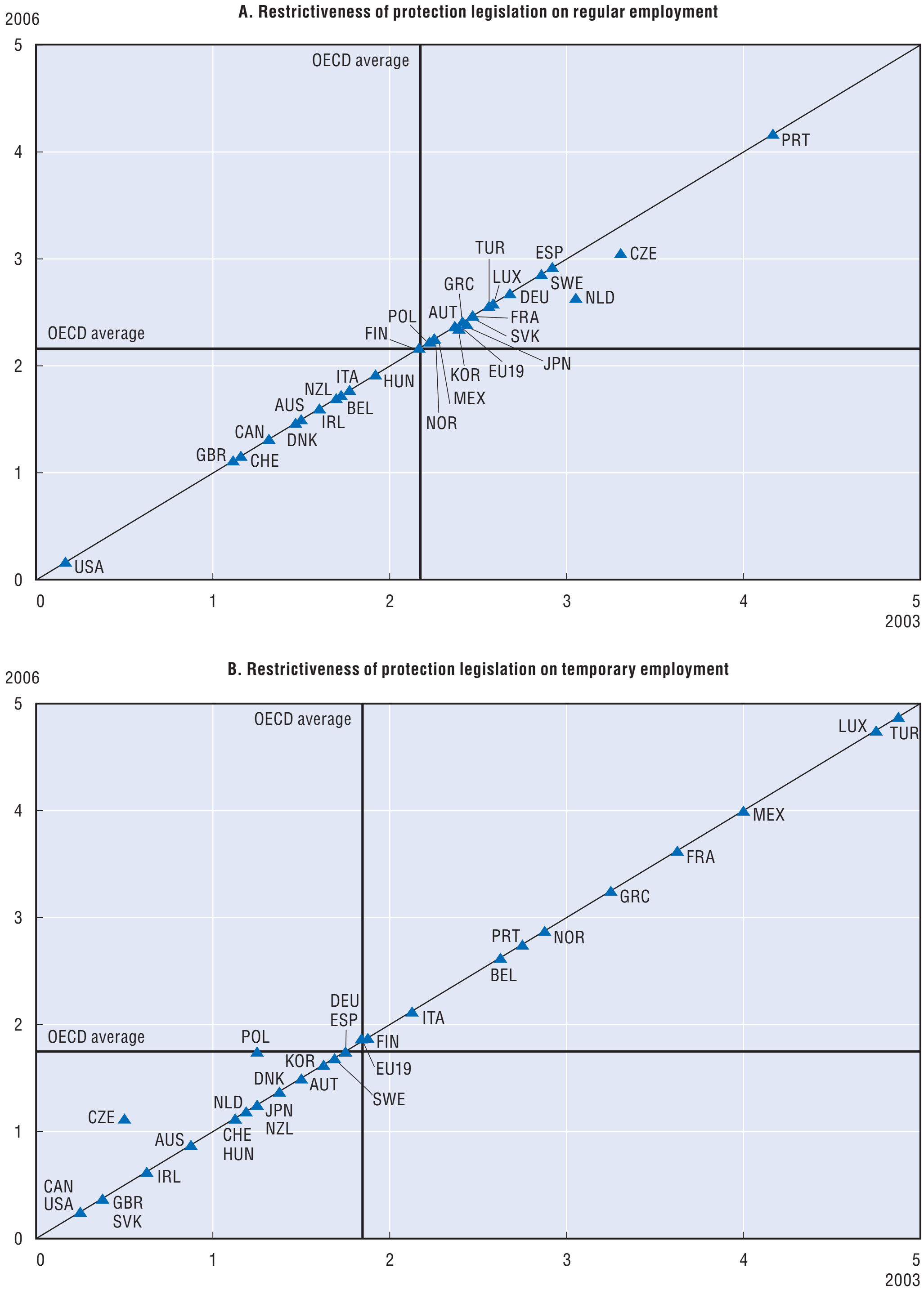
1. Disability benefits include benefits received from schemes to which beneficiaries have paid contributions (contributory) from programmes financed by general taxation (non-contributory) and from work injury schemes. Data for the Czech Republic, Germany and Italy are for 2003.
2. OECD average only for the countries shown on the graph.

Source: Chart A: OECD, *Transforming Disability into Ability*, 2003 and OECD calculations; Chart B: *OECD Employment Outlook* (Chapter 1), 2004 and OECD calculations.

StatLink: *http://dx.doi.org/10.1787/011734384822*

Figure 3.8. **Employment Protection Legislation (EPL)**

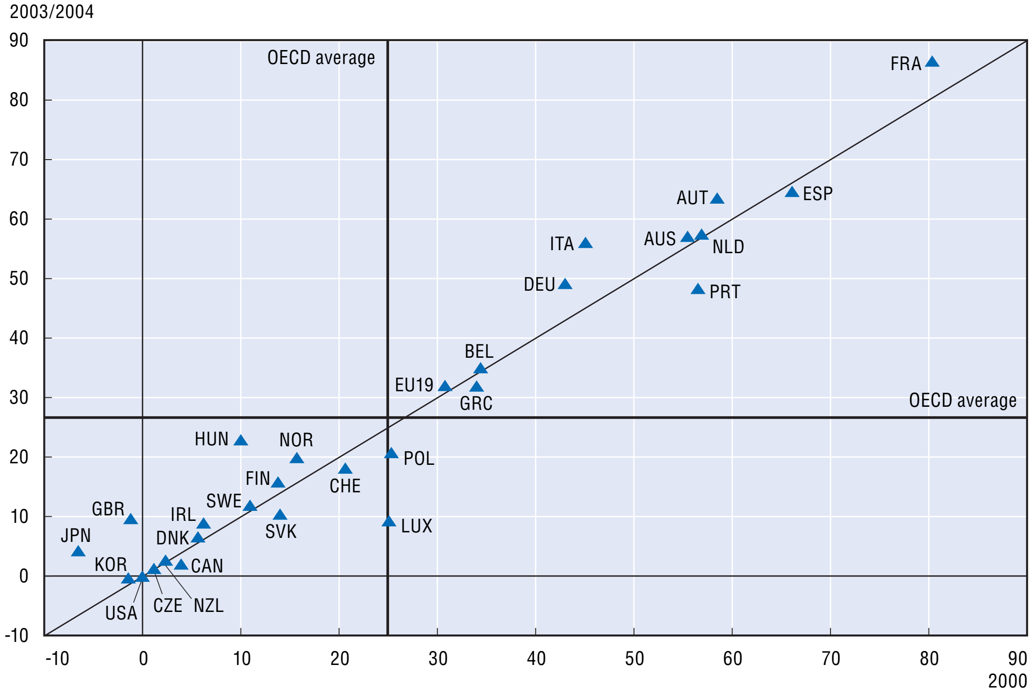
Indicator scale of 0-6 from least to most restrictive



Source: *OECD Employment Outlook* (Chapter 2), 2004 and OECD calculations.

StatLink: *http://dx.doi.org/10.1787/844322800175*

Figure 3.9. **Difference between coverage rates of collective bargaining agreements and trade union density rates**[1]



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. Each data point on the figure is calculated as the simple arithmetic difference between the two rates.

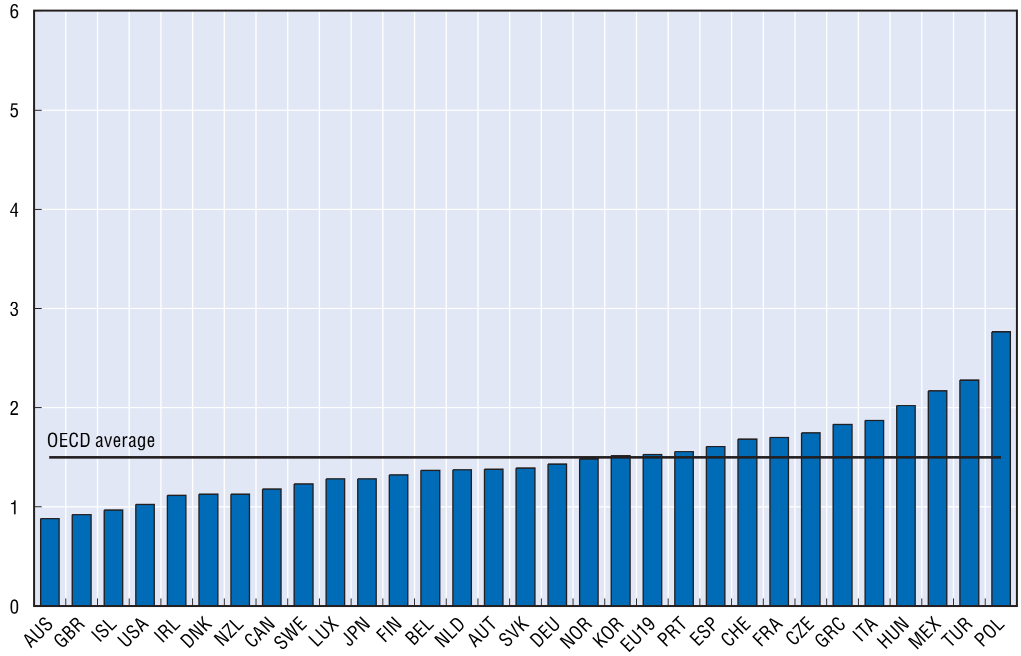
Source: *OECD Employment Outlook* (Chapter 3), 2004 and National sources.

StatLink: *http://dx.doi.org/10.1787/381257611057*

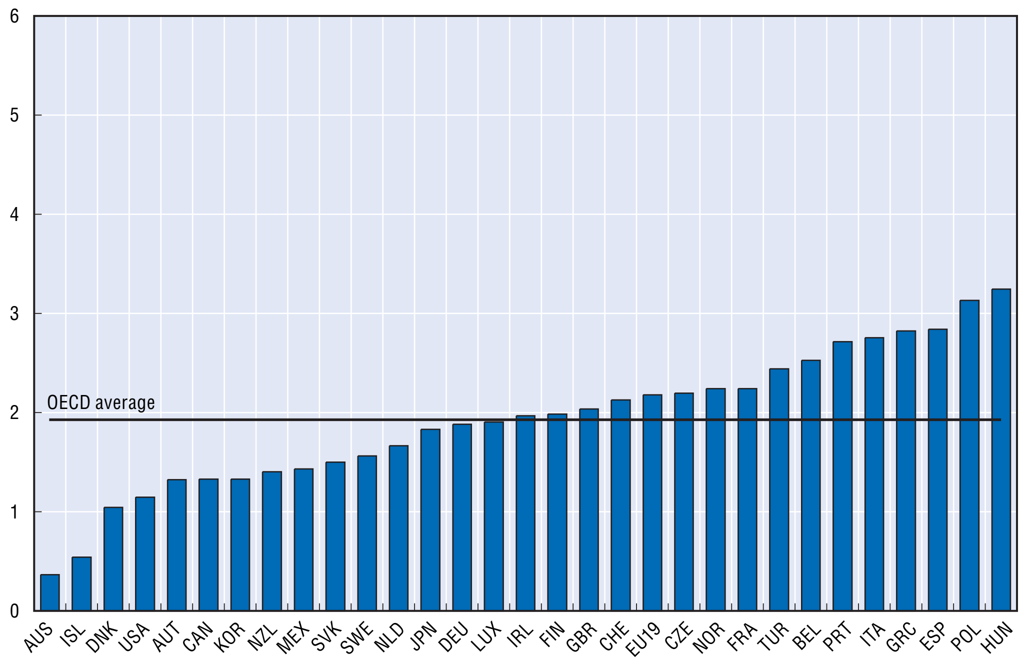
Figure 3.10. **Product market regulation, 2003**

Indicator scale of 0-6 from least to most restrictive

A. Restrictiveness of economy-wide product market regulation[1]



B. Restrictiveness of regulation having an impact on economic behaviour[1]



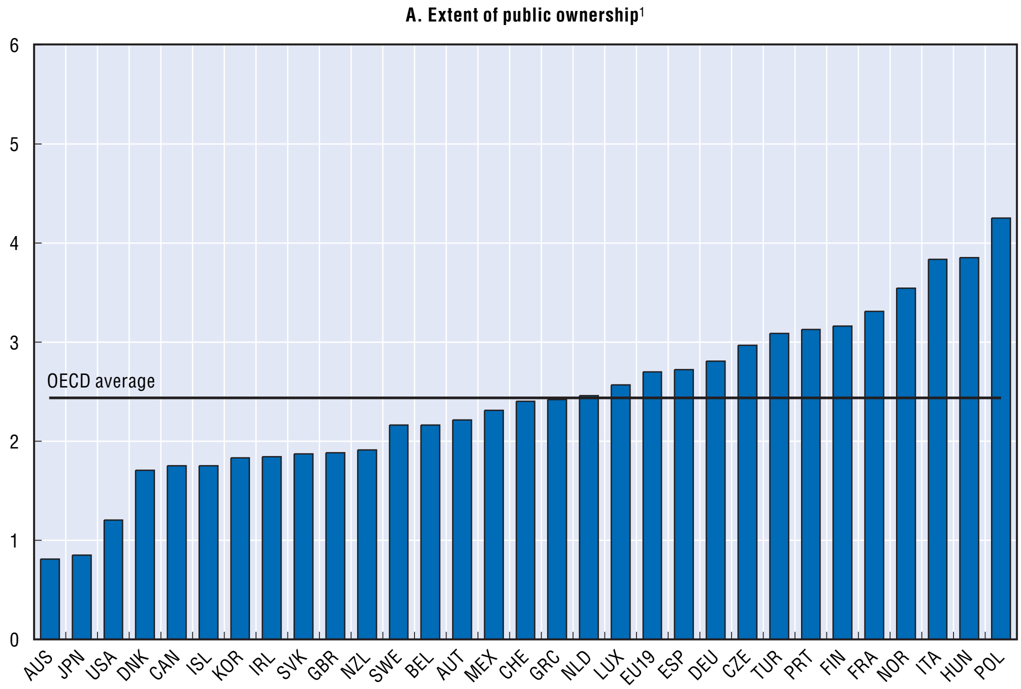
1. Economic regulation includes all domestic regulatory provisions affecting private governance and product market competition such as state control and legal barriers to entry in competitive market.

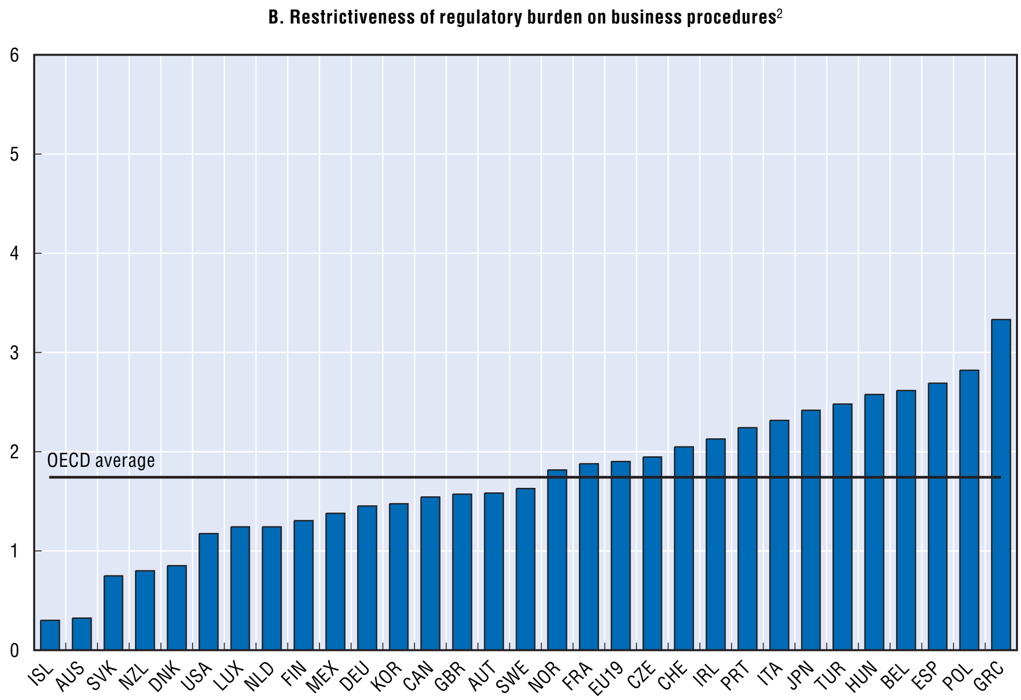
Source: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/364577011403*

Figure 3.11. **State control of business operations, 2003**

Indicator scale of 0-6 from least to most restrictive





1. Covers scope and size of public entreprise 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, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/320566656434*

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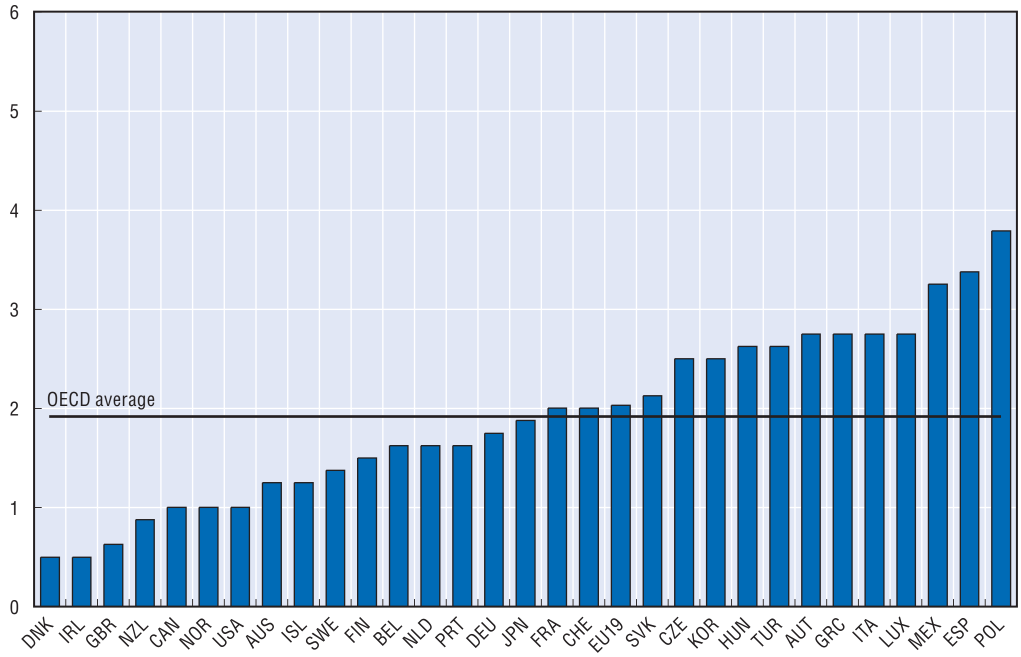
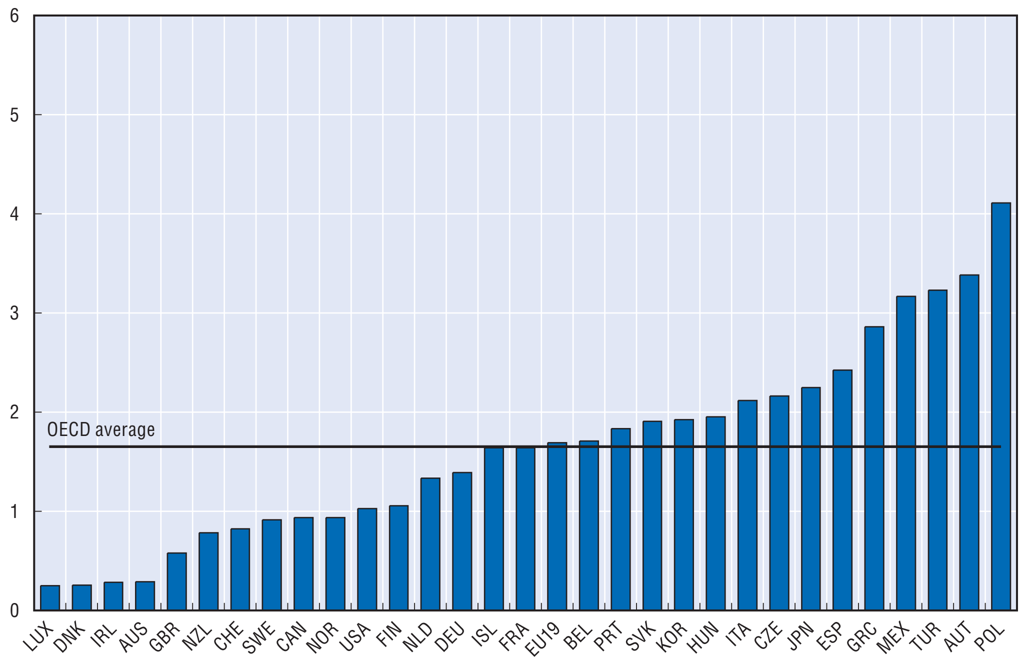
Figure 3.12. **Barriers to entrepreneurship, 2003**

Indicator scale of 0-6 from least to most restrictive

A. Administrative burdens on corporations and sole proprietor start-ups



B. Sector-specific administrative burden



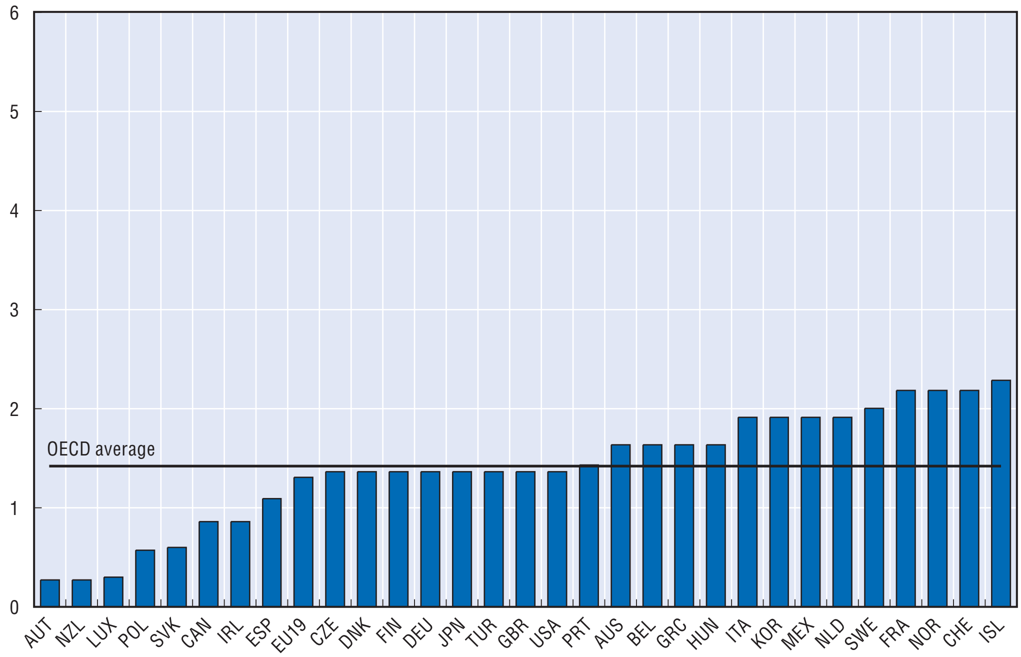
Source: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/500215753737*

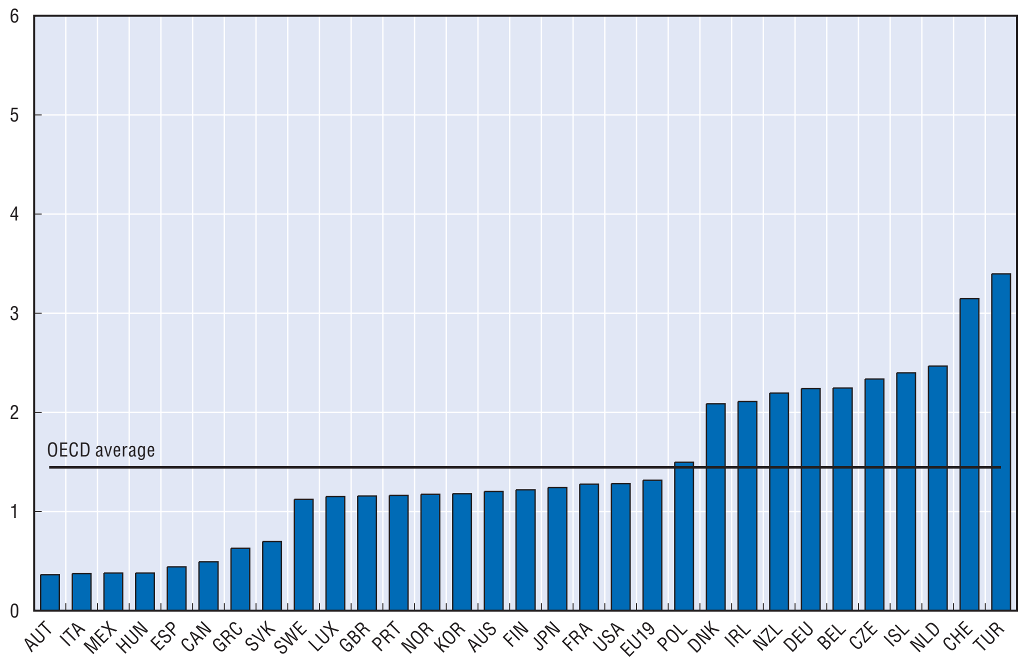
Figure 3.13. **Barriers to entry, 2003**

Indicator scale of 0-6 from least to most restrictive

A. Legal barriers to entry in industries



B. Complexity of administrative procedures[1]



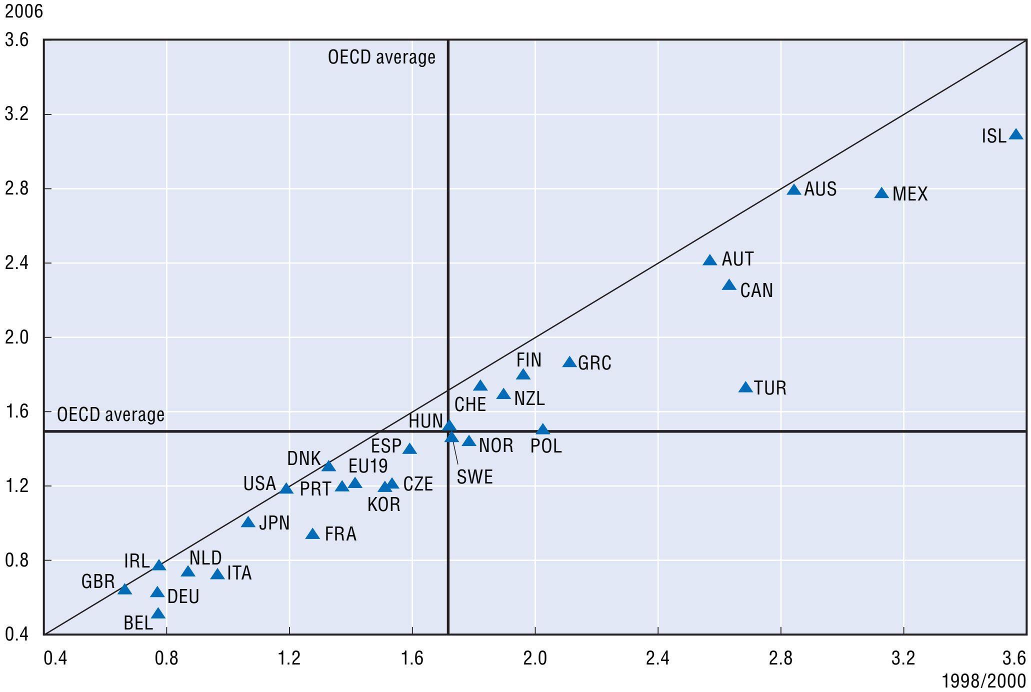
1. Concerns complexity of government communication of rules and procedures as well as of licences and permit systems.

Source: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/103018278262*

Figure 3.14. **Barriers to foreign direct investment**

Indicator scale of 1-10 from least to most restrictive

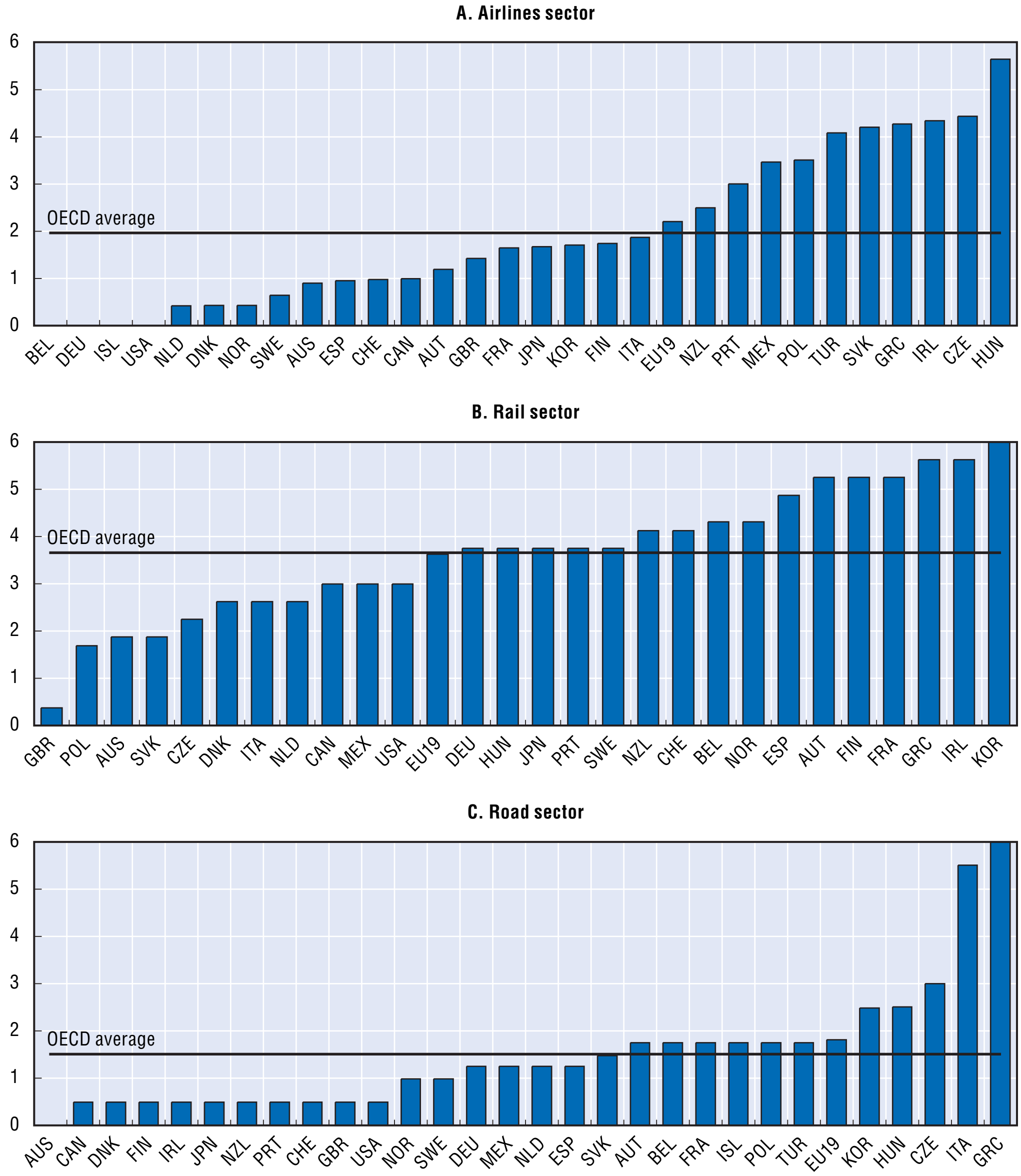


Source: Koyama, T. and S.S. Golub (2006), "OECD's FDI restrictiveness index: revision and extension to more economies", *OECD Economics Department Working Papers*, No. 525.

StatLink: *http://dx.doi.org/10.1787/375265001700*

Figure 3.15. **Sectoral regulation in the transport sector, 2003**

Indicator scale of 0-6 from least to most restrictive

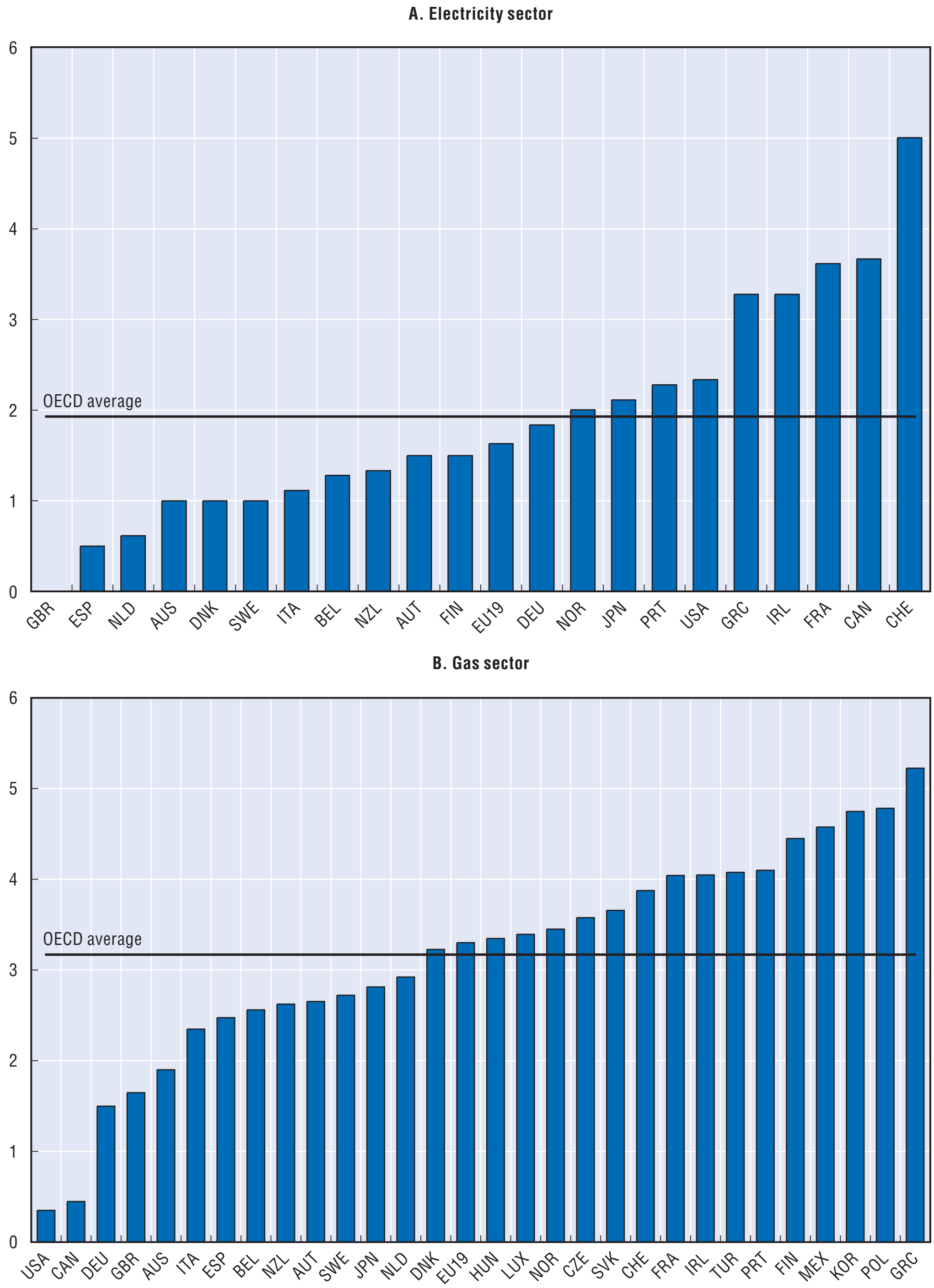


Source: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/804054457422*

Figure 3.16. **Sectoral regulation in the energy sector, 2003**

Indicator scale of 0-6 from least to most restrictive

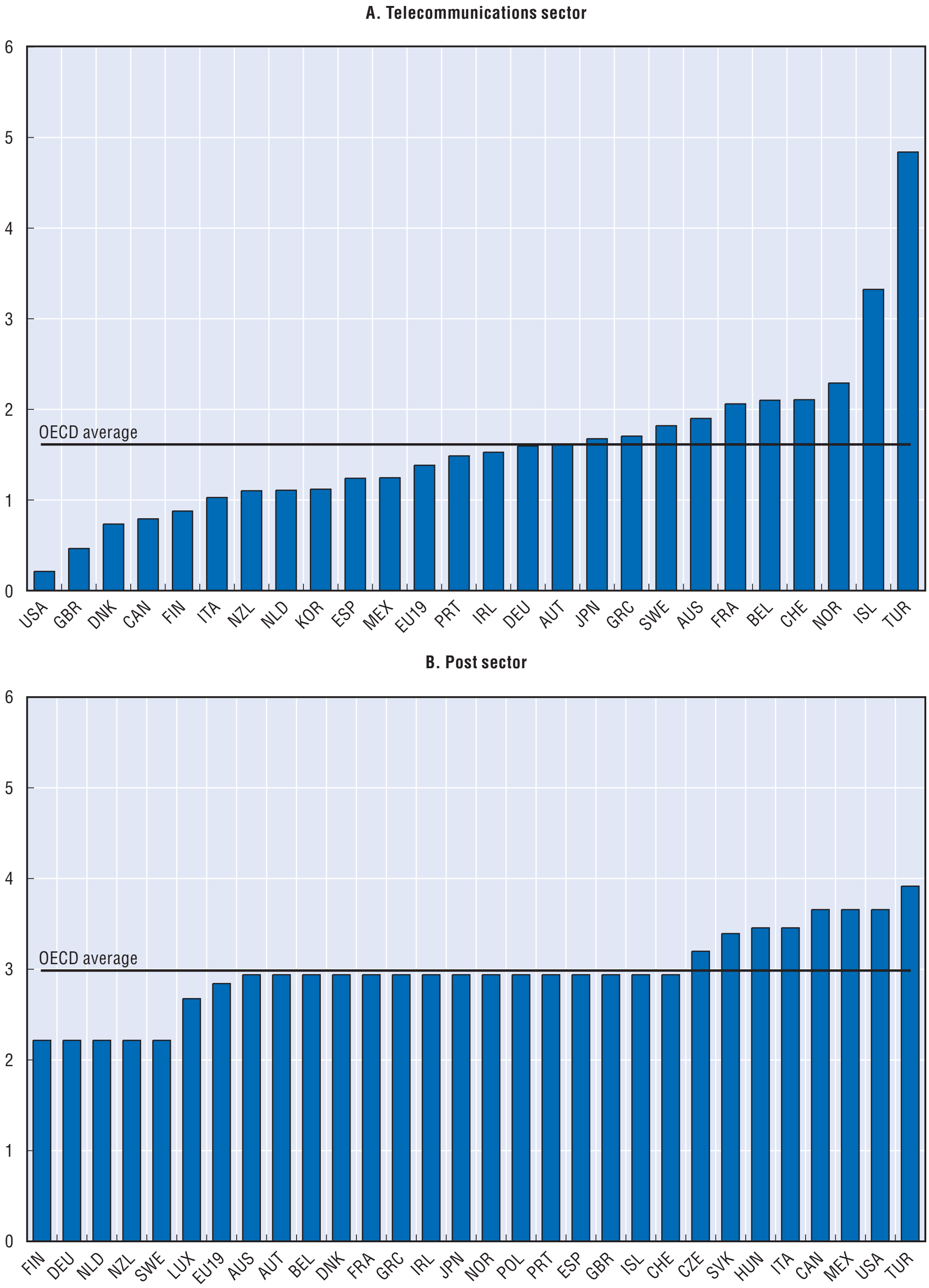


Source: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/660401847052*

Figure 3.17. **Sectoral regulation in the post and telecommunications sectors, 2003**

Indicator scale of 0-6 from least to most restrictive

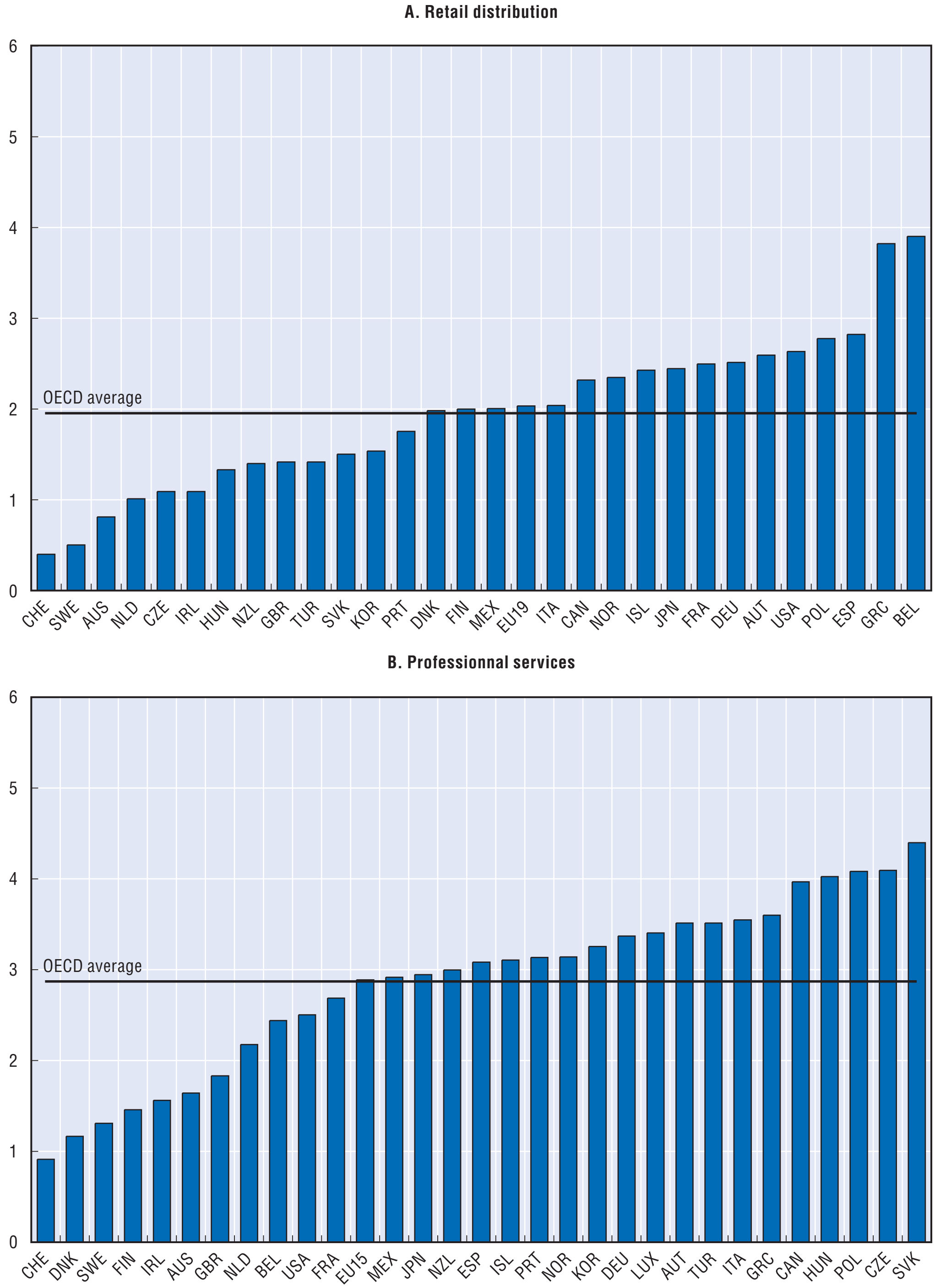


Source: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/783107837732*

Figure 3.18. **Sectoral regulation in retail distribution and professionnal services, 2003**

Indicator scale of 0-6 from least to most restrictive

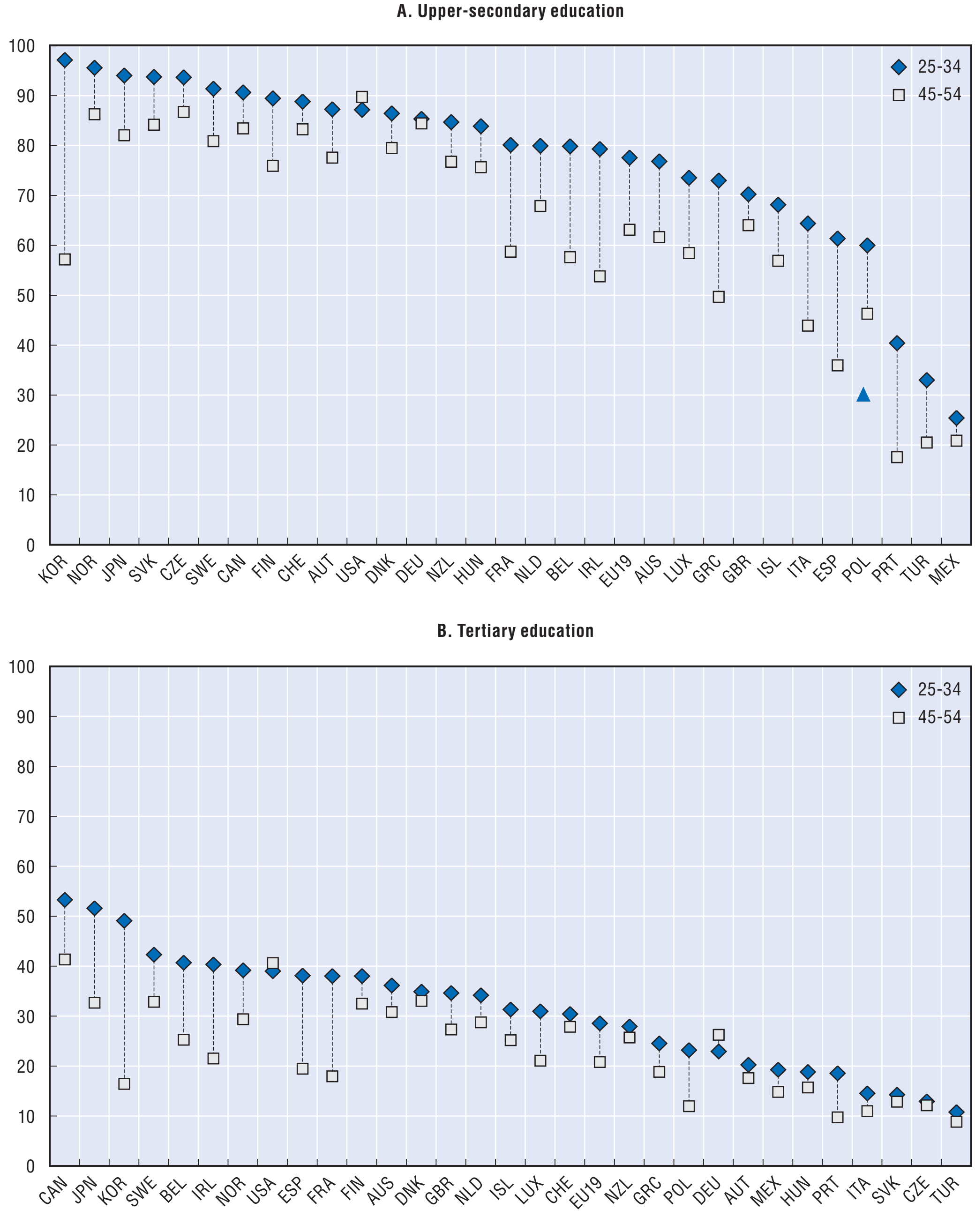


Source: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/502402112638*

Figure 3.19. **Educational attainment, 2004**

Percentage of population aged 25-34 and 45-54



Source: OECD, *Education at a Glance*, 2006.

StatLink: *http://dx.doi.org/10.1787/782230317042*

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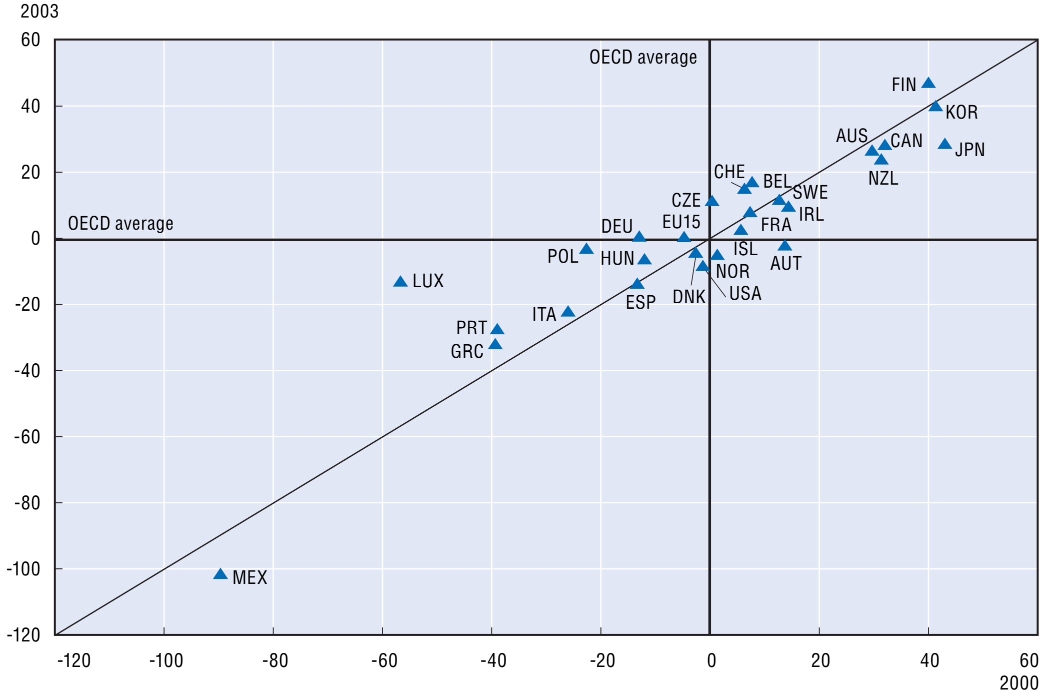
Figure 3.20. **Educational achievement**

Average of PISA scores in reading, mathematics and science[1]



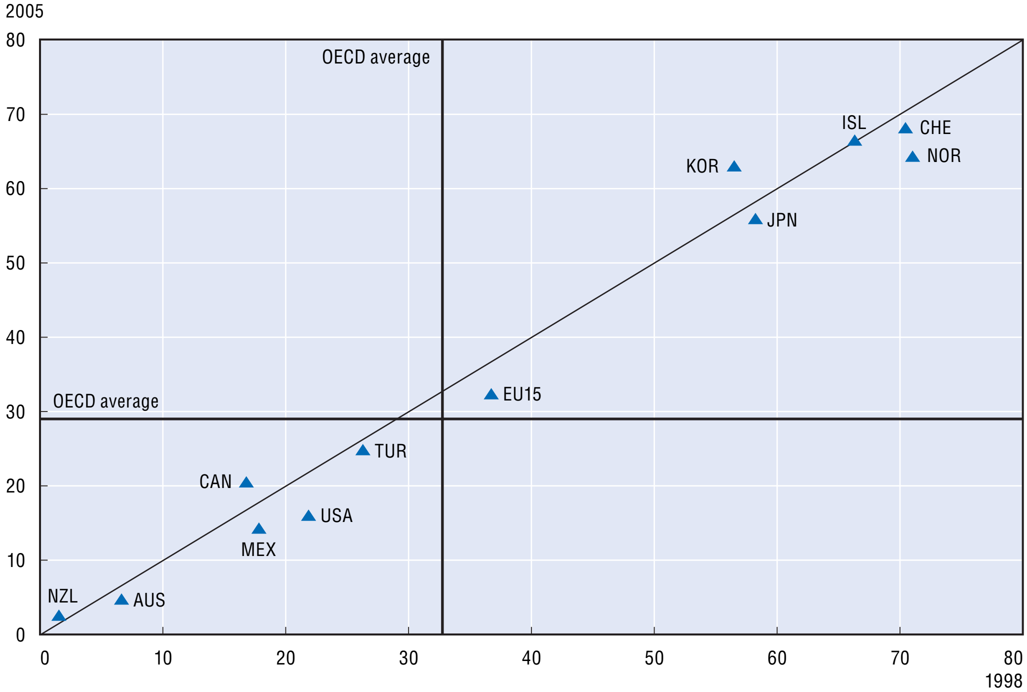
1. PISA stands for Programme for International Student Assessment.

Source: OECD, PISA 2003 database.

StatLink: *http://dx.doi.org/10.1787/202066778082*

Figure 3.21. **Producer support estimate to agriculture**[1]

Percentage of of farm receipts



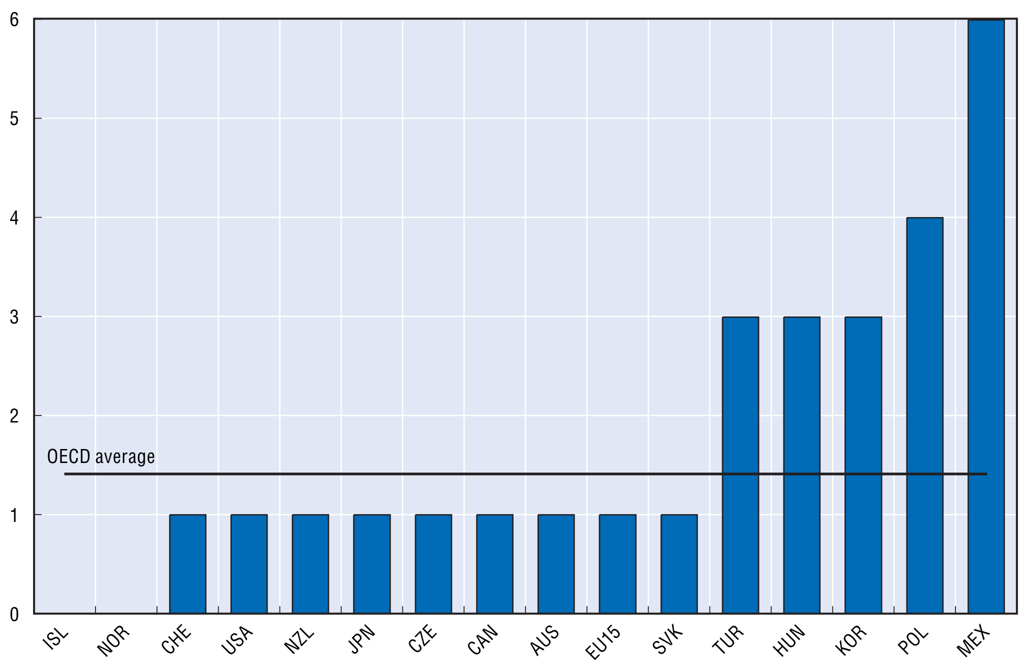
1. A single producer support estimate is calculated for EU countries.

Source: OECD, Producer and Consumer Support Estimates database.

StatLink: *http://dx.doi.org/10.1787/466164008538*

Figure 3.22. **Importance of external trade tariffs, 2003**

Index scale of 0-6 from least to most restrictive

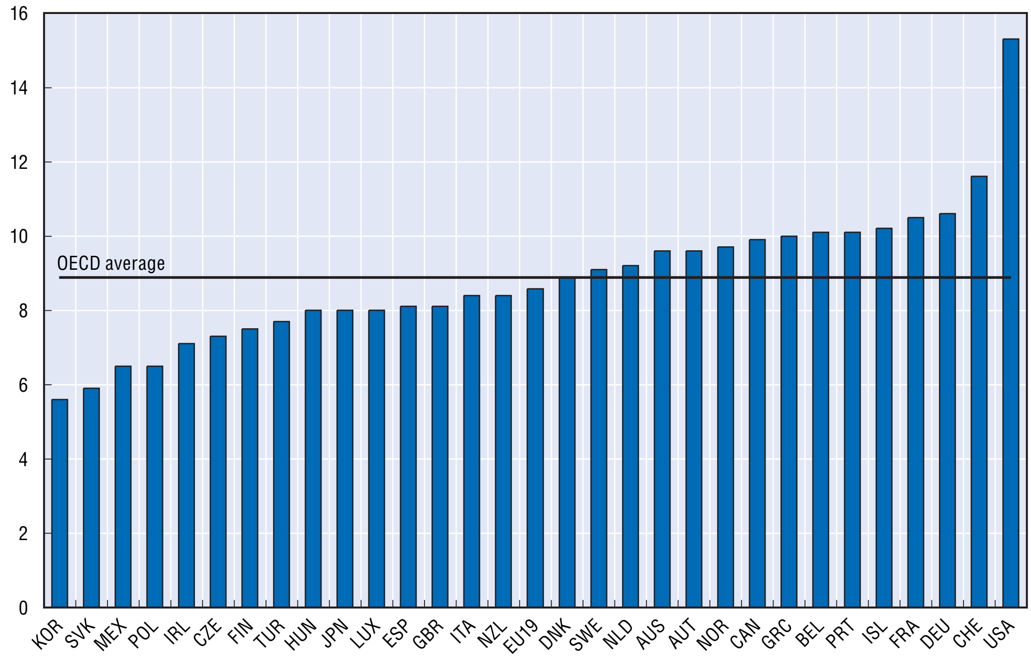


Source: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/466164008538*

Figure 3.23. **Health expenditure, 2004**[1]

Percentage of GDP



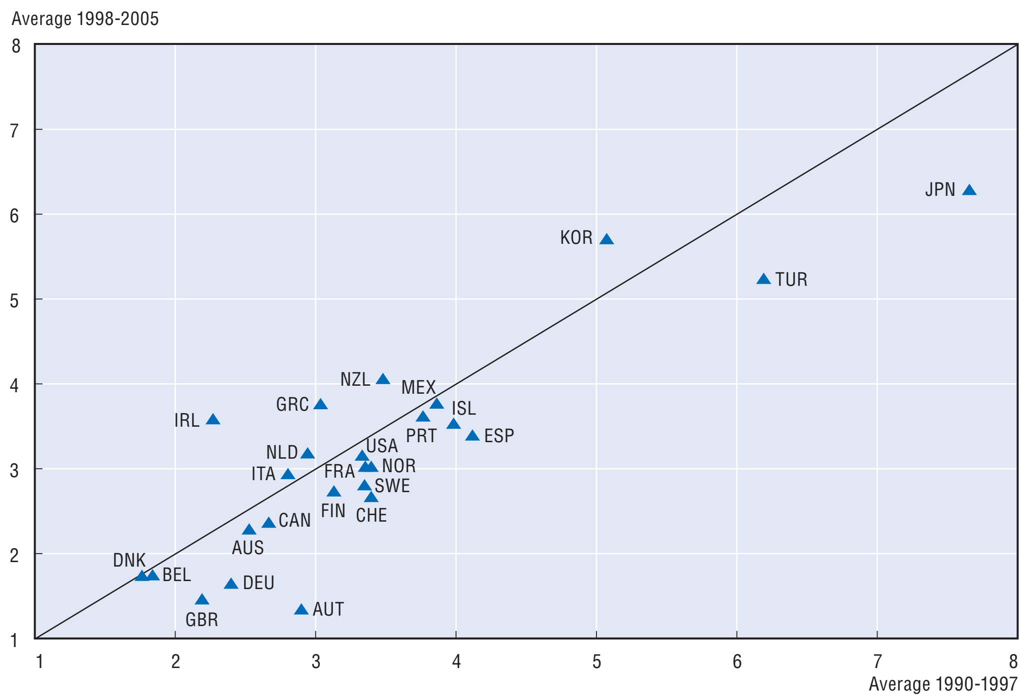
1. 2003 for Belgium, Japan and the Slovak Republic.

Source: OECD, *Health Data 2006: Statistics and Indicators for 30 Countries.*

StatLink: *http://dx.doi.org/10.1787/778224435710*

Figure 3.24. **Public investment**

Percentage of GDP



Source: *OECD Economic Outlook*, No. 80.

StatLink: *http://dx.doi.org/10.1787/778224435710*

PART II

Thematic Studies

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Economic Policy Reforms
Going for Growth

PART II

Chapter 4

The Employment Effects of Policies and Institutions

Beside the positive social impact of employment, labour utilisation is a key determinant of material living standards. In this regard, persistent cross-country differences in employment rates explain a good deal of the observed gaps in GDP per capita. These differences appear to reflect to a significant extent the impact of policy and institutional settings, which vary substantially in terms of effectiveness across OECD countries. This chapter builds on new OECD research undertaken in the context of the reassessment of the OECD Jobs Strategy *to identify some of the main policies and institutions affecting employment outcomes.*

Introduction

The 1994 OECD *Jobs Strategy* stressed the need for fundamental labour market reform to boost employment levels, which in a number of OECD countries had been held back by distortions created by policies and institutions. Since then, some countries have succeeded in improving labour market performance through reforms – including many of those advocated by the 1994 *Strategy* – while others have made less progress. Recent empirical research has also brought to light new evidence regarding the role of policies and institutions for employment. Reflecting the need to verify that previous conclusions still hold up in the light of new evidence and to incorporate the experience gained with innovative policy approaches, the *Jobs Strategy* has been revisited in the 2006 OECD publications *Boosting Jobs and Incomes: Policy Lessons from Reassessing the OECD Jobs Strategy* and *OECD Employment Outlook: Boosting Jobs and Incomes*.[1]

This chapter builds on recent OECD research undertaken within the context of the reassessment of the *Jobs Strategy* (see in particular Bassanini and Duval, 2006), as well as on the wide body of available research on labour markets, to identify some of the policies and institutions that shape employment outcomes. Following a brief review of changes in labour market performance over the past decade, it assesses the main policy influences on employment via labour supply and demand, explores the role of macroeconomic policies and their interplay with existing policy frameworks, and examines the benefits of hypothetical reforms in OECD countries. Although the chapter focuses primarily on those policies and institutions whose effects on employment patterns have been quantified by OECD research, the revised *Jobs Strategy* shows that other difficult-to-quantify policy factors also contribute to labour market performance. These include *inter alia* the design of non-employment benefit systems, such as sickness, disability and social-assistance benefit schemes, as well as the quality of education systems and the availability of training opportunities throughout the working life.

The main findings of the chapter are as follows:

- Policies and institutions play a major role in explaining employment patterns. In particular, OECD research undertaken within the context of the reassessment of the *Jobs Strategy* finds that, on average, changes in policies and institutions explain about half of the cross-country variance in unemployment trends over the past two decades.
- In general, high and long-lasting unemployment benefits, high tax wedges and stringent anti-competitive product market regulation (PMR) increase unemployment and depress labour force participation. By contrast, highly centralised and/or co-ordinated wage bargaining systems as well as certain categories of public spending on active labour market programmes (ALMPs) appear to reduce unemployment. Different policy packages may yield similar employment outcomes, although not necessarily with the same effect on overall economic performance and public finances.
- Apart from these general policies, the job prospects of certain population groups, such as older workers, women and youth, are also influenced by other, more specific, policies. For example, early retirement incentives embodied in public pension schemes and other

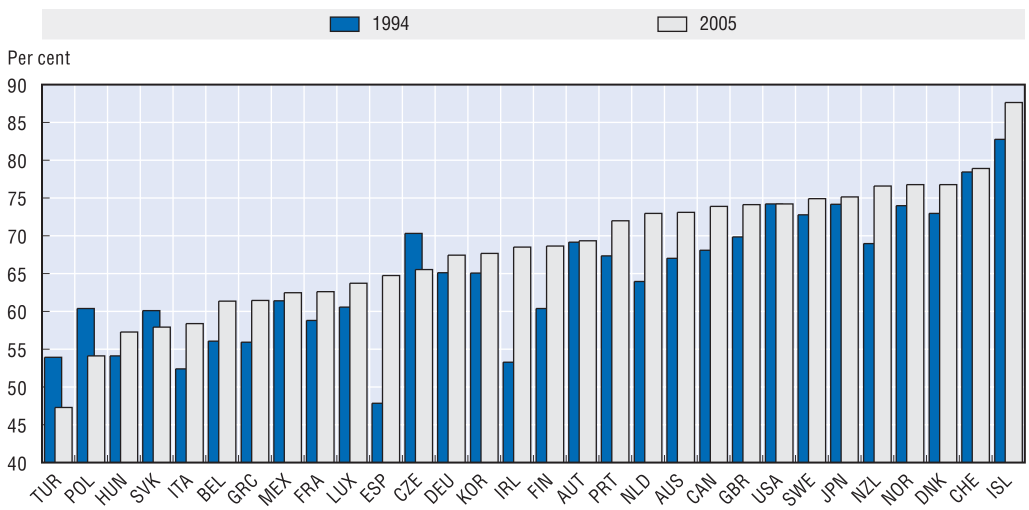
social transfer programmes depress employment at older ages.[2] Childcare subsidies boost female participation but child benefits reduce it. As well, a minimum wage set at a too high level is likely to deteriorate the job prospects of youth.

- Changes in macroeconomic conditions can have a long-lasting influence on labour market performance. Supply-side changes, such as a productivity slowdown, a terms-of-trade deterioration or an increase in long-term real interest rates, reduce employment initially, but the extent to which they do so, as well as the speed at which employment subsequently recovers, depends on existing policies and institutions. In general, policy settings that have adverse effects on labour market performance in the long run will also tend to prolong adjustment to adverse shocks.
- On the demand side, a downturn can interact with policies and institutions in and around the labour market to have negative, persistent effects on jobs. This heightens the importance of avoiding excessive macroeconomic fluctuations, and establishing and maintaining macroeconomic policy geared towards reducing cyclical fluctuations.
- There is significant scope for policy reforms to boost employment and increase its resilience in the face of adverse shocks in many OECD countries. In particular, a reduction in the tax wedge, a moderate cut in unemployment benefits, further product market liberalisation and/or higher and better spending on ALMPs could cut unemployment rates by several percentage points.

Labour market performance over the past decade and key challenges

Over the past decade, employment rates have increased in the vast majority of OECD countries (Figure 4.1), owing to lower unemployment and/or higher labour force participation rates. Particularly large reductions in unemployment took place in Spain, Ireland, Finland and, to a lesser extent, in a few other English-speaking and Nordic

Figure 4.1. **Employment rates have risen in most OECD countries**[1]

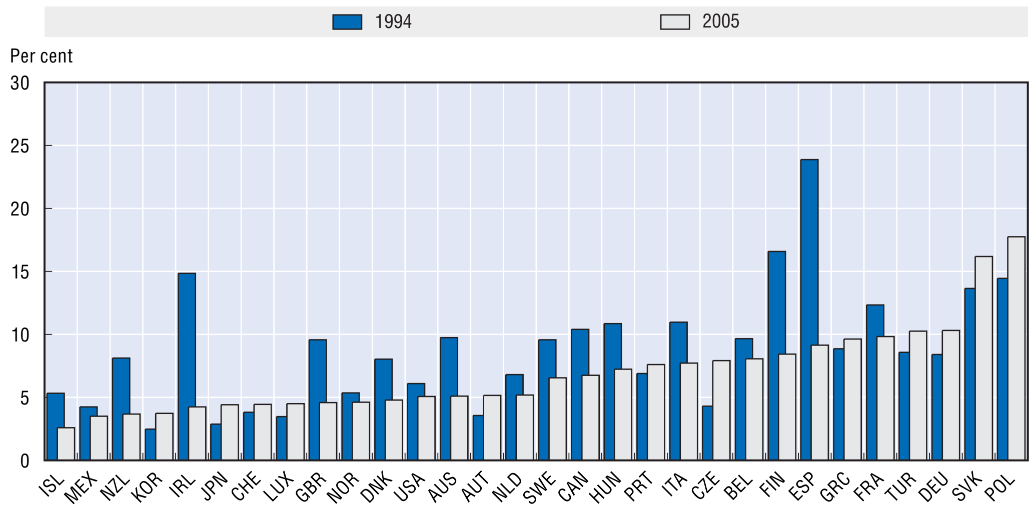


1. Countries are ranked in ascending order of employment/population ratios in 2005. The employment/population ratio refers to the persons employed aged 15 and over divided by the population aged 15-64.

Source: OECD (2006b).

StatLink: *http://dx.doi.org/10.1787/043315017336*

Figure 4.2. **Unemployment rates have tended to fall since the mid-1990s**[1]



1. Countries are ranked in ascending order of unemployment rates in 2005. Refers to the persons aged 15 and over.
Source: OECD (2006b).

StatLink: *http://dx.doi.org/10.1787/710852317765*

countries (Figure 4.2). The trend decline in labour force participation among older workers has also come to a halt or been reversed, and female participation rates have continued to increase except in countries where they were already close to those of men.

However, overall employment rates continue to differ markedly across OECD countries, from below 60% in Italy, Hungary, Poland, the Slovak Republic and Turkey, to over 75% or more in some Nordic countries, New Zealand and Switzerland. There are few differences in the employment rates of prime-age males, which tend to be high and stable in all OECD countries. By contrast, there are wide cross-country disparities in the labour supply of traditionally under-represented groups in the labour market, including prime-age women, older workers, youth, immigrants and the low-skilled (Figure 4.3).

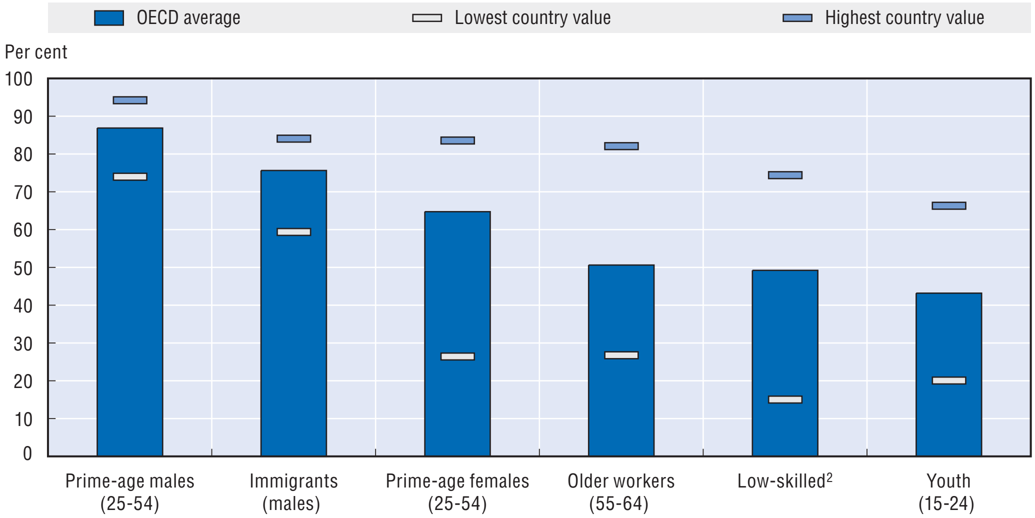
Policies to raise labour supply

The extent to which people participate in the labour market depends in part on the design of welfare systems and active labour market programmes, as well as their interplay. For certain groups, more specific factors also play a role, such as the design of retirement schemes in the case of older workers and family policies in the case of women.

Welfare systems and labour market programmes

High unemployment benefits available for a long duration can reduce employment by weakening the job-search intensity of the unemployed and their willingness to accept job offers. By lowering the economic cost of unemployment, they may also induce workers to claim higher wages, thereby pricing some of them out of the labour market.[3] On the other hand, unemployment benefits are an essential protection against hardship and may give jobseekers more time to find jobs that better match their skills, which enhance productivity. If the effects of unemployment benefits on job-search intensity and wage claims dominate the potentially favourable impact on the quality of jobs, a trade-off between social objectives and efficiency arises.

Figure 4.3. **Employment rates differ markedly across population groups, 2004**[1]



1. Some of the groups overlap. For each category except male immigrants, OECD average is calculated as population-weighted averages across all OECD countries. For male immigrants, Iceland, Japan, Korea, New Zealand, Poland and Turkey are excluded.
2. Data for the low-skilled group refer to 2003 except for Iceland, Italy and the Netherlands, where they refer to 2002.

Source: OECD, Labour Force Statistics database and National sources.

StatLink: *http://dx.doi.org/10.1787/073664765420*

Existing empirical analysis yields robust evidence that the level and duration of unemployment benefits increase unemployment.[4] Consistent with these findings, OECD research suggests that for the "typical" OECD country, a 10 percentage point increase in the unemployment benefit replacement rate raises the aggregate unemployment rate by 1 to 1½ percentage points and lowers the employment rate by about 2 to 2½ percentage points.

However, the extent to which high and long-lasting unemployment benefits reduce job-search intensity and push up wage claims depends on benefit eligibility conditions and the monitoring of job search and sanctions. Well-designed "activation" policies can at least partly offset the disincentive effects of high unemployment benefits. This is particularly the case when jobseekers have to look actively for jobs, accept job offers, participate in labour market programmes or else face benefit sanctions, and when they are provided with effective re-employment services, counselling, training and financial incentives.

In practice, OECD research indicates that high unemployment benefits have smaller effects on unemployment when they are associated with high public expenditures on ALMPs, possibly because high spending on ALMPs is often accompanied by strong emphasis on activation. In addition, available research in this area, including that undertaken by the OECD, suggests that certain categories of ALMPs improve labour market performance not only via their interactions with unemployment benefits, but also more directly.[5] This seems to be the case of public training programmes for the unemployed which, by improving their competencies, aim to improve their chances to find stable jobs. These findings may explain to some extent why certain – mainly Nordic – OECD countries have been able to maintain comparatively high and long-lasting unemployment benefits while at the same time achieving relatively low unemployment and high labour market participation.

Tax incentives and other policies targeted at under-represented groups

Tax incentives also matter in influencing the decision to participate in the labour market. By reducing employees' rewards relative to their contribution to production, high tax rates tend to depress labour supply and effort. This is of particular relevance for certain groups in the labour market which are at greater risk than skilled prime-age males of being caught in "inactivity traps".

Taxation may have a particularly strong impact on the decision of married women to work outside the home. Insofar as home production, such as housework and childcare, has traditionally been regarded as a closer alternative to market production for women than for men, the extent to which married women work outside the home is more sensitive to changes in the net wage. Likewise, because of family responsibilities, women have been more inclined than men to work part-time in a number of OECD countries. As a result, taxes in income ranges most representative for part-time workers are likely to have a greater impact on female labour force participation. Yet, married women are effectively taxed more heavily than single individuals in most OECD countries, and they also often face strong disincentives to work part-time, reflecting *inter alia* the progressivity of income tax schedules and the loss of certain income-related allowances.[6] As OECD work and other available studies[7] confirm, this affects female participation and job prospects.

One way for governments to offset tax-induced distortions to the participation of mothers is to ensure that childcare is affordable. Apart from ensuring a competitive environment in services that will help to keep prices low, this may involve subsidising the use of childcare facilities. From the perspective of offsetting the effects of taxation on female labour force participation, childcare subsidies seem preferable to child benefits. The latter are intended to enhance incomes of families with children, but the associated increase in income lowers work incentives and, ultimately, female participation and employment. Indeed, in line with existing literature, OECD research shows that childcare subsidies increase female employment whereas child benefits reduce it. Parental leave, if not overly long, is another factor stimulating female labour force participation.

Labour force participation of older workers is also likely to be sensitive to financial incentives. Public pension schemes and other social transfer programmes can erode the gains from working at older ages, which in turn may induce early labour market withdrawal. This is notably the case in a number of Continental European countries, where the gain from continuing to work beyond certain ages – in terms of higher future pension receipts – is often too small to offset the cost of doing so – in terms of contributions paid and foregone benefits. The disincentives embodied in old-age pension systems are particularly important after the age at which such benefits become available. Prior to that, special early-retirement schemes, and disability and unemployment benefit schemes with special arrangements for older workers, discourage continued work. OECD evidence shows that such disincentives to continued work strongly affect the employment of older workers.[8]

Policies to raise labour demand

Employers' willingness to hire workers depends to an important extent on the cost of employment. This in turn depends on tax wedges, the design of the system of wage determination and the cost of employment protection. Labour demand is also affected by the strength of competition in product markets, which is partly determined by product market regulations.

Taxation of labour income

High taxes reduce either labour supply or labour demand, depending on whether their burden falls onto wage earners – in the form of lower net wages – or employers – in the form of higher labour costs. The more employees succeed in obtaining compensation for higher personal income taxes, social security contributions and consumption taxes by pushing up their wages, the more labour demand declines and unemployment rises. This is especially the case if employers cannot compensate for higher payroll taxes by reducing wages, as may happen for instance in the presence of binding minimum wages or wage floors created by social transfers.

A number of empirical studies have found that high taxes tend to increase unemployment rates,[9] although others are less conclusive.[10] The OECD research finds a robust effect, with a 10 percentage point increase in the tax wedge raising the unemployment rate by almost 3 percentage points for the "typical" OECD country. The impact on the employment rate is even larger: a 10 percentage point increase in the tax wedge would reduce it by about 3½-4 percentage points, reflecting the fact that high taxes not only increase unemployment but also discourage labour market participation. This is an average estimate, however, as the actual effect varies across countries depending on their institutional framework and, in particular, on their wage-setting institutions and policies.

Wage-setting institutions and policies

The new OECD analysis finds that a high legal minimum wage amplifies the unemployment effects of labour taxes, consistent with the view that a binding minimum wage prevents employers from obtaining a compensation for payroll taxes in the form of lower wages. In line with some other studies,[11] there is also some – albeit weaker – evidence that labour taxes may have stronger effects in countries with an intermediate degree of centralisation and/or co-ordination of the wage bargaining process. In such an environment, where workers typically bargain over wages at the sectoral level, trade unions may have more leeway and incentive to offset higher taxes by pushing for higher wages or resist attempts by employers to compensate for higher payroll taxes by reducing wages.

Wage-setting institutions and policies impact on unemployment not only indirectly, via their interplay with labour taxes, but also more directly. Set at a moderate level, a statutory minimum wage should have little or no effect on unemployment.[12] However, a minimum wage set at a high, binding level is likely to price the least productive workers out of employment, and possibly out of the labour force if, as in the case of youth or low-skilled women, their attachment to the labour market is weaker.[13] OECD research has found no evidence in general across OECD countries that statutory minimum wages have direct effects on aggregate employment. This is in line with the somewhat inconclusive results found in the literature.[14]

The employment effects of the structure of collective bargaining are complex. On the one hand, decentralised wage bargaining at the firm level has often been regarded as employment-friendly, preventing excessive wage claims since this would lead to a loss of market shares to competitors with detrimental effects on employment. On the other hand, under very centralised or co-ordinated bargaining systems, bargaining parties may be better aware of the harmful effects that excessive wage pressure can have on aggregate inflation and employment. This in turn may facilitate wage moderation and job creation.[15] From this perspective, intermediate systems based on branch-level bargaining without higher-level co-ordination may yield the worst outcomes, as they benefit neither from the gains associated with centralised/co-ordinated systems nor from the advantages of bargaining at the decentralised level. Intermediate-level bargaining may have particularly adverse effects when the government often intervenes directly in wage determination by extending collective contracts to whole industries, as is the case in a number of Continental European countries. Such extensions reduce the scope for competition to moderate wage claims and to increase labour demand.

Some empirical work supports this "hump-shaped" hypothesis, according to which labour market performance is better under decentralised and centralised/co-ordinated systems than under intermediate ones.[16] More recent OECD work underlines the employment benefits of highly centralised and/or co-ordinated regimes. These are found to be associated with a 1-1½ percentage point decline in unemployment rates on average, compared with other regimes.

Employment protection legislation (EPL)

Strict job protection constitutes a cost to firing workers, which may entail disincentives to hiring in the first place. This will be the case in particular where the involvement of the judicial system makes firing costs hard to predict. As a result, EPL is expected to reduce both inflows to and outflows from unemployment, implying an ambiguous impact on unemployment. However, by reducing turnover, strict EPL is likely to increase the length of unemployment spells and thereby long-term unemployment. Likewise, the job prospects for those groups with relatively weak attachment to the labour market, such as young workers and women, can be compromised. In this respect, not only the stance of EPL matters, but also its design.

Also, dualistic labour markets – in which extensive protection for workers on permanent contracts coexists with light regulation for workers on temporary contracts – may enable permanent workers to raise their wages without much risk of job loss. The resulting wage pressure would then reduce overall labour demand.[17] In addition, deregulated temporary contracts may merely increase the turnover in this segment of the labour market – potentially implying disincentives to train the workers concerned – without constituting a stepping-stone to permanent work relationships, as these remain costly to dissolve.[18] This has raised concerns that an easing of EPL focused on temporary contracts and without changes for permanent contracts may generate substantial insecurity for those on temporary contracts while not necessarily improving labour market performance.[19]

While some studies have found negative effects of stringent EPL on aggregate employment,[20] other evidence, including OECD research, finds no significant impact.[21] However, EPL has been shown to increase long-term unemployment and to reduce employment for groups "at the margin" of the labour market, notably youth.[22] There is also some tentative empirical evidence that relaxing EPL for temporary contracts while maintaining strict protection for permanent ones may ultimately undermine labour market performance.

Product market regulation (PMR)

Stronger competition in product markets increases employment in the long run.[23] Lower barriers to entry curb market power and monopoly profits and make entry of new firms possible. Both factors tend to expand activity levels and labour demand. Moreover, lower monopoly profits reduce the scope for incumbent workers to share in the rents generated by excessive prices. Reduced rent sharing between employers and employees would then tend to shorten the length of unemployment spells as it would become less attractive for the unemployed to prolong and limit search for job opportunities in "high-wage" sectors.

A recent body of empirical research points to negative employment effects of competition-restraining regulations.[24] In line with these findings, new OECD research finds that such regulations – which include *inter alia* barriers to entrepreneurship, barriers to trade and investment and state involvement in business operations – increase unemployment. These estimates suggest that, for the "typical" OECD country, product market liberalisation which has taken place over the past ten years has cut the aggregate unemployment rate by about one percentage point.

The role of macroeconomic conditions and macroeconomic policies

Cross-country differences in policy settings do not only lead to permanent differences in employment levels but also to divergent employment outcomes in the aftermath of macroeconomic shocks. In this context, policy reforms may yield a "double dividend" by lifting employment levels permanently, while at the same time improving the resilience of employment following adverse economic events. Also, macroeconomic policies geared towards reducing cyclical fluctuations are helpful to moderate the impact of macroeconomic shocks.

Policies and institutions shape the employment effects of macroeconomic shocks

OECD economies are frequently subject to macroeconomic shocks affecting output and employment. For example, a sudden productivity slowdown, a terms-of-trade deterioration or an increase in long-term real interest rates all push up unemployment. The extent to which they do so hinges on existing policies and institutions, however. For instance, badly designed benefit systems or weak competition in product markets may amplify the initial job losses as the economy is hit by adverse macroeconomic shocks and/or make them more persistent. By contrast, the wage-moderating effect of highly centralised and/or co-ordinated bargaining systems can help moderate the decline in employment. Also, certain categories of ALMPs – such as job-search assistance – enhance the chances of laid-off workers finding new jobs, thereby contributing to a swift employment recovery. Other policies and institutions, such as EPL or PMR, may have more complex effects. On the one hand, by protecting workers from the risk of job and income loss, strict EPL may damp the initial impact of shocks. On the other hand, by hindering the necessary wage adjustment, it may delay the return of employment back to its pre-shock level.[25]

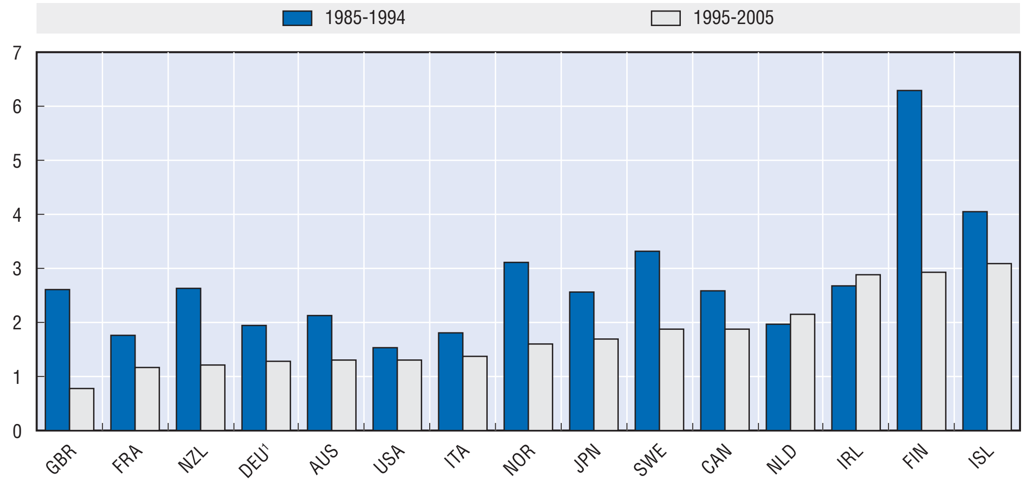
In practice, OECD empirical research finds that the employment effects of macroeconomic shocks are larger when unemployment benefits are high, but lower under centralised and/or co-ordinated bargaining systems and, more tentatively, when public spending on ALMPs is high. There is also evidence that strict EPL and stringent PMR cushion the initial employment impact of shocks but make them last longer.

Macroeconomic policies can help minimise the impact of macroeconomic shocks

The fact that shocks to the whole economy can interact with policies and institutions to damage jobs heightens the importance of avoiding excessive macroeconomic fluctuations and cushioning adverse shocks. The magnitude of cyclical fluctuations has declined across the OECD over the past decade, although sizeable cross-country

Figure 4.4. **The magnitude of cyclical fluctuations has declined across the OECD over the past decade**

Standard deviation of quarterly output gaps



1. Data before 1991 refer to Western Germany.

Source: *OECD Economic Outlook*, No. 79.

StatLink: *http://dx.doi.org/10.1787/386018053503*

differences remain (Figure 4.4). Reduced output volatility reflects a variety of factors,[26] including the growing prevalence of stability-oriented monetary policy frameworks across the OECD, under which central banks have become increasingly committed to maintaining low and stable inflation. Fiscal policy also plays a role in stabilising aggregate demand through automatic stabilisers and potentially through discretionary changes in spending and taxation. Fiscal stabilisation is particularly important in countries that do not have national monetary policy. However, to allow fiscal policy to play a role for stabilisation purposes, it is necessary to have sound overall public finances that ensure there is always a margin of manoeuvre when faced with an unexpected downswing. This has not been the case over the past cycle in many countries, which followed pro-cyclical discretionary policy[27] in the previous upswing and thus entered the downswing with a weak underlying fiscal balance that limited their scope even to allow automatic stabilisers to work.

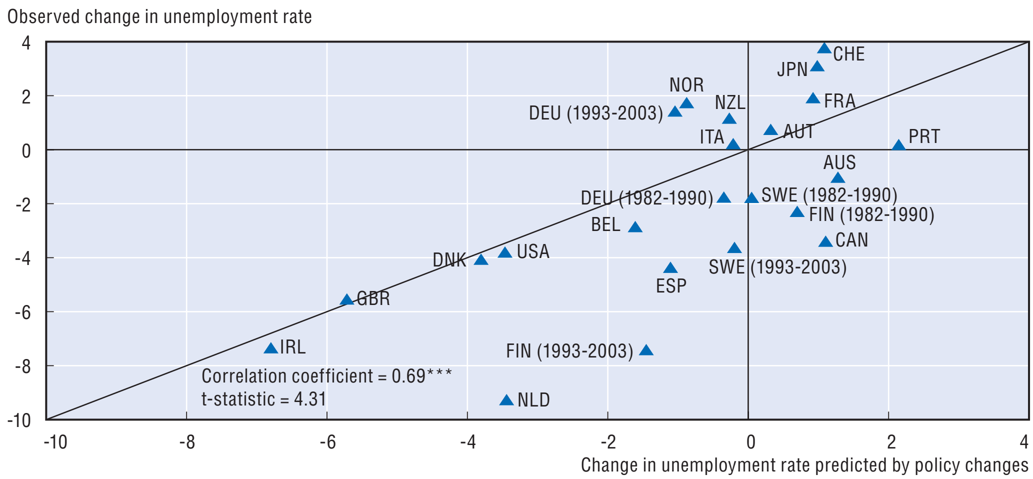
Macroeconomic policy geared towards reducing cyclical fluctuations may also bring forward the employment gains from labour and product market reforms. Indeed, while structural reforms ultimately yield sizeable benefits, these effects can take some time to materialise insofar as aggregate demand does not initially expand in line with the increased output potential. However, any demand shortfall typically puts downward pressure on observed and expected inflation, thereby leading monetary authorities to reduce policy interest rates. This increases aggregate demand to meet the higher supply potential of the economy brought about by structural reforms, and results in greater macroeconomic stability than if the adjustment is left to markets alone. For public finances, sustained higher employment implies a lasting increase in tax revenues and cuts in some spending components. If the starting point for government finances is sound, this offers scope for easing of fiscal policy and hence an additional way to raise aggregate demand to match the increase in aggregate supply. Moreover, if the easing is concentrated on taxes and spending components which in turn further boost supply, a virtuous cycle can commence whereby reforms offer scope for even more reforms. For example, structural reforms can allow taxes on labour to be lowered, which in turn increases employment further, with additional beneficial effects on public finances, and so forth.

The overall impact of policy changes in the past on employment and the benefits of future reforms

Overall, the evolution of unemployment across OECD countries over the past two decades can be explained to a significant extent by policy reforms in the areas of labour taxes, unemployment benefit schemes, product markets and wage-setting systems. Based on OECD empirical analysis,[28] it appears that policy reforms alone account for about half[29] of the cross-country difference in unemployment trends over the period 1982-2003 (Figure 4.5). Many of the countries that succeeded in lowering unemployment undertook important reforms in their product markets and tax-benefit systems (*e.g.* Denmark, Ireland, Netherlands and the United Kingdom). Policy changes were less employment-friendly in those countries where unemployment stagnated or rose (*e.g.* France, Japan and Switzerland).

Figure 4.5. **Policy reforms explain a significant share of cross-country differences in unemployment trends**[1]

Changes in unemployment explained by policy changes, 1982-2003



1. Estimates on the basis of the unemployment rate regression presented in Bassanini and Duval (2006), Table 1.2, Column 1.

Source: Bassanini and Duval (2006).

StatLink: *http://dx.doi.org/10.1787/020028756881*

The OECD empirical analysis can also be used to illustrate the potential gains from policy reforms (Table 4.1).[30] Such a simulation exercise suggests that a policy package including a reduction in the tax wedge, a moderate cut in unemployment benefits, further product market liberalisation and higher and better spending on active labour market policies could cut unemployment rates by several percentage points in a number of OECD countries. This is notably the case in Continental European countries, such as Belgium, France, Germany, Italy, Portugal or Spain, where unemployment remains high and room for reform exists in several of the above policy areas.

Table 4.1. **Policy reforms that can reduce unemployment**

In the average OECD country, the unemployment rate can be reduced by 1 percentage point…
– by reducing the average unemployment benefit replacement rate by 8 percentage points
or
– by reducing the overall tax wedge on labour income by 3.5 percentage points
or
– through product market liberalisation of the same order of magnitude as that which has taken place in the average OECD country over the past ten years
or
– by raising spending on active labour market policies per unemployed worker (as a share of GDP per capita) to the Swedish level
… or by several percentage points through a combination of the above policy reforms

Policy reforms would also improve the resilience of employment to adverse shocks. For instance, for countries such as Austria, Belgium, Finland, France, Greece, Ireland, Italy, Japan, Norway, Portugal, or Switzerland, bringing product market regulation down to the level currently observed in the most competition-friendly OECD country (the United Kingdom) could possibly reduce by several years the time needed to recover the initial job losses induced by a shock.[31]

Notes

1. OECD (2006a, 2006b).
2. Furthermore, while such schemes were often implemented in the hope that labour market withdrawal of older workers would improve the job opportunities of younger ones, this has proved to be a failure in practice.
3. Furthermore, benefits need to be financed by taxes, which in turn may further reduce employment (see below).
4. For analysis using cross-country/time-series macroeconomic data, see Scarpetta (1996), Nickell (1998), Elmeskov *et al.* (1998), Nunziata (2002), and Nickell *et al.* (2005). For recent microeconometric evidence at the country level, see *inter alia* Bennmarker *et al.* (2005), Card and Levine (2000), Carling *et al.* (2001), Cockx and Ries (2004), Lalive *et al.* (2006), and Roed and Zhang (2003).
5. See Bassanini and Duval (2006); Boone and Van Ours (2004).
6. For details, see Jaumotte (2004) and OECD (2005), Chapter 6.
7. See *e.g.* Smith *et al.* (2003).
8. See Duval (2004) and OECD (2005), Chapter 5.
9. Belot and Van Ours (2004), Daveri and Tabellini (2000), and Nickell (1997).
10. MacCulloch and di Tella (2002), Nunziata (2002), and Scarpetta (1996).
11. Daveri and Tabellini (2000), and Elmeskov *et al.* (1998).
12. It may even reduce unemployment if employers have some discretion in wage-setting – so-called "monopsony power" – as may happen for instance if their employees cannot easily find a job elsewhere. In the absence of a binding minimum wage, employers would set both wage and employment levels below the levels that would prevail in a more competitive labour market.
13. High social benefits may also establish binding wage floors in practice, as people are unlikely to accept work that pays little more than the benefits that can be obtained.
14. In particular, while some studies find evidence of negative effects of minimum wages on youth employment (Neumark and Wascher, 1999; OECD, 1998, Chapter 2), others do not detect any impact (Card and Krueger, 1995; Dolado *et al.* 1996; and Elmeskov *et al.* 1998).
15. However, the tendency for centralised or co-ordinated bargaining systems to harmonise wages and working conditions across workers and/or geographical areas could reduce the job prospects of certain population groups and/or regions (see *e.g.* Siebert, 1997).

16. See Flanagan (1999) and Scarpetta (1996).
17. Bentolila and Dolado (1994).
18. Blanchard and Landier (2002).
19. See Blanchard and Landier (2002), and Dolado *et al.* (2002).
20. Using cross-country time-series macroeconomic data, Elmeskov *et al.* (1998) and Scarpetta (1996) find that strict EPL increases unemployment in OECD countries. Certain microeconomic studies have also found negative effects of EPL on employment for non-OECD countries (see in particular the collection of papers in Heckman and Pagés, 2003).
21. Nickell (1997), Nickell *et al.* (2005) and Nunziata (2002) obtain no significant unemployment effect of EPL. New research reported in OECD (2006b) and Bassanini and Duval (2006) finds no significant impact either. This difficulty in identifying effects using macroeconomic data may to some extent reflect the difficulties in capturing the many dimensions of EPL – *e.g.* its enforcement and predictability – in simple indicators. However, certain microeconomic studies do not find any aggregate employment effects of EPL either (see for instance Autor *et al.*, 2006, or Kugler and Pica, 2005).
22. See OECD (2004, 2006b).
23. See Chapters 5 and 6. See also Amable and Gatti (2001), Blanchard and Giavazzi (2003), Ebell and Haefke (2003), Krueger and Pischke (1997), Messina (2006), Pissarides (2001) and Spector (2002).
24. Boeri *et al.* (2000), Messina (2005), and Nicoletti *et al.* (2001).
25. See *e.g.* Blanchard (1999).
26. See *e.g.* Dalsgaard *et al.* (2002).
27. *E.g.* normal cyclical increases in tax revenues were offset by structural cuts in tax rates.
28. See Bassanini and Duval (2006).
29. The correlation in Figure 4.5 is 0.69, corresponding to an R^2 of 0.48.
30. Using econometric estimates to gauge the potential employment effect of policy reforms has two main caveats, however. First, in practice, the impact of a given reform may depend upon countries and circumstances, not least because other policy settings may offset or amplify the employment effects of the reform. For instance, the unemployment impact of a reduction in unemployment benefit replacement rates might be smaller in those OECD countries where well-designed activation policies already provide the unemployed with adequate job-search incentives. The other caveat is that the unemployment impact of the reform is implicitly assumed to be a simple linear function of the policy change. This assumption holds only insofar as large reforms are comparable in nature to smaller ones.
31. This estimation is based on results presented in Bassanini and Duval (2006), *op. cit.*, Table 1.12, Column 6.

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Economic Policy Reforms
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PART II

Chapter 5

Product Market Regulation and Productivity Convergence

Rapid technological progress over recent years has offered the opportunity for all countries to increase their level of productivity and prosperity. However, some economies have been better able than others to take advantage of these innovations. Those with lightly regulated product markets have tended to gain most. This chapter summarises new OECD research that shows how competition-restraining regulations in product markets slow the diffusion of new innovations, notably by reducing investment in information and communications technologies, and hindering inward foreign direct investment.

Introduction

Rapid technological change over the past decade has created the opportunity for OECD countries to raise labour productivity. The new technologies, related mainly to computer and other information and communications technologies (ICT), hold great potential. Given that these innovations have become widely available, their development might have been expected to lead to similar increases in productivity across countries over the past ten years. However, this did not occur as some countries have been better able to take advantage of the new technological breakthroughs, contributing to increased dispersion of productivity performance within the OECD area.

This chapter explores how competition-restraining product market regulation has affected the international diffusion of best-practice production techniques.[1] It looks at how such regulation evolved up to 2003; how it affected productivity catch-up in the face of the rapid developments in ICT of the past decade; and how reforms aimed at strengthening competition could raise growth and contribute to productivity convergence among OECD countries. The main findings of the OECD research summarised here are:

- Despite a broad tendency towards product market liberalisation, regulations still restrict competition in non-manufacturing sectors.
- Competition-restraining product market regulations have an adverse effect on productivity as they slow the adoption of best-practice production techniques; this particularly harms countries that are far behind the technological frontier in some industries.
- Restrictive regulation retards the diffusion of new technology through at least two channels: it discourages investment in equipment that embodies the latest ICT, and reduces the diffusion of technology from abroad through foreign direct investment (FDI).
- Over the period 1995-2003, annual productivity growth could have been at least ¾ of a percentage point higher in half of the countries considered if regulations that hinder competition had been at the level of the most lightly regulated in the OECD for each sector.
- Looking ahead, many countries could achieve substantial gains in labour productivity growth, of at least half a percentage point per annum over a decade, by further reforming their product markets.

Past regulatory reform and remaining barriers to competition in OECD markets

Product markets in the OECD area have been substantially liberalised in past decades (Figure 5.1). As reforms since the early 1990s have been the strongest in countries where regulation was initially the most constraining for competition, differences in the regulatory stance across countries narrowed over recent years.

However, some important differences in regulation persist across sectors (Figure 5.2). By 2003, the regulatory stance remained restrictive for the gas, postal services and rail transport sectors. Certain inherently competitive sectors, such as retail distribution and professional services, were subject to regulations that substantially held back competition.

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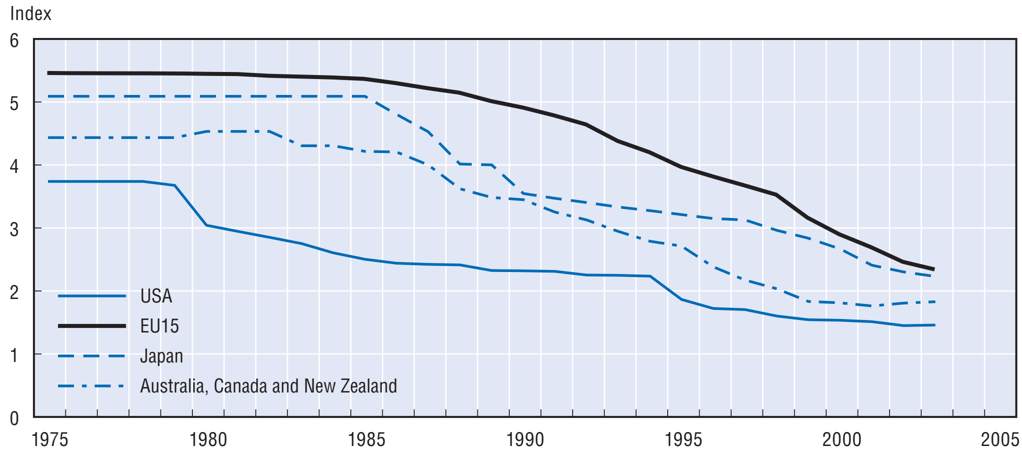
Figure 5.1. **Developments in the regulation of network industries, 1975-2003**[1]

The scale of the indicators is 0-6 from least to most restrictive



1. Based on summary indicators of competition-restraining regulatory conditions in seven network sectors: airlines, telecommunications, electricity, gas, post, rail and road freight. EU15 excludes Luxembourg.

Source: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/677000785410*

Figure 5.2. **OECD average of indicators of restrictive regulations, 2003**[1]

The scale of the indicators is 0-6 from least to most restrictive

1. Unweighted average of countries for which data are available. The indicators of regulation in network industries are as in Figure 5.1. The OECD indicator of regulatory stance for professional services covers the legal, accounting, architecture and engineering professions with respect to entry and conduct regulations. The indicator for retail distribution covers entry, operational restrictions and price controls. The finance indicator refers to the regulation of the financial system and is taken from de Serres *et al.* (2006).

Source: OECD, Product Market Regulation database and Conway and Nicoletti (2006).

StatLink: *http://dx.doi.org/10.1787/256200722821*

Even within relatively liberalised sectors, such as telecommunications and road transport, there remained substantial scope to reduce competition-restraining regulation.

Regulations in non-manufacturing industries have important "knock-on" effects throughout the economy because these industries supply intermediate inputs to other sectors. Across industries, there is substantial variation in the impact of regulation in non-manufacturing sectors because some depend more heavily on these intermediate inputs than others. The differences between industries in the overall impact of regulation appear largely to be explained by the varying "knock-on" effects of weak competitive pressures in the business services, retail distribution and transport sectors (Box 5.1).

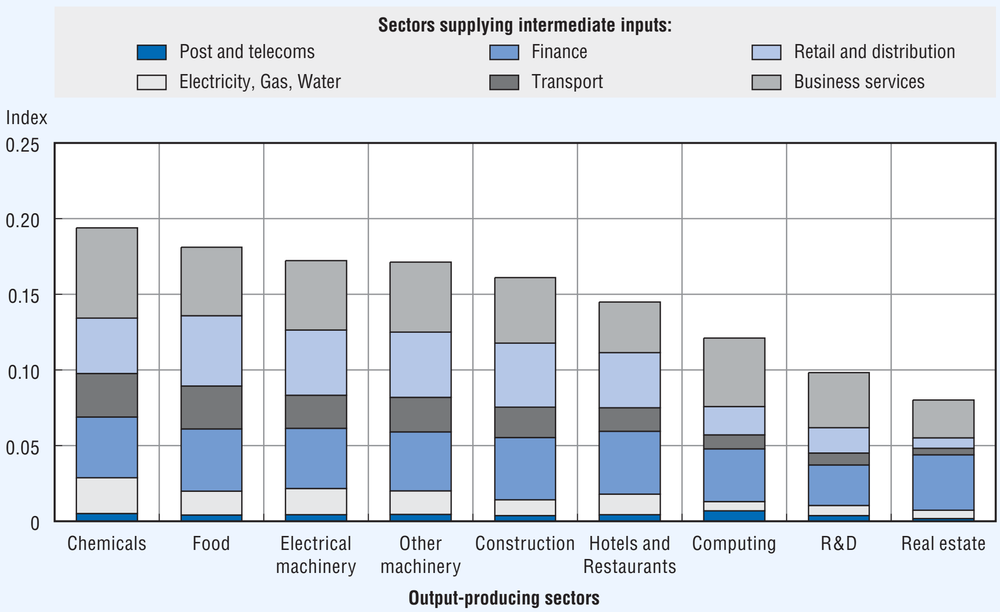
Box 5.1. "Knock-on" effects of sectoral regulation

There are important "knock-on" effects throughout the economy of competition-restraining product market regulation in the non-manufacturing sectors. These effects arise because the sectors where competition is restricted provide intermediate inputs to other sectors. The limited competition among suppliers may increase the cost of inputs and make the products supplied less innovative and of poorer quality. This in turn lowers productivity in the output-producing sectors and may damage growth prospects. For example, weak competition in legal services could hinder productivity in other industries by making it costly to obtain legal advice to start a company or protect new inventions.

The "knock-on" effects on a given industry can be assessed by weighting indicators of the restrictiveness of regulation in non-manufacturing sectors by their shares of the output-producing industry's total inputs. This shows, for example, that the energy-intensive chemicals industry is more exposed than other industries to "knock-on" effects from regulation in electricity, gas and water (see figure below). The greatest "knock-on" effects generally arise from the regulatory stance in the business services, retail distribution and finance sectors, because these sectors provide a substantial part of intermediate inputs for output-producing industries and carry a significant regulatory burden. Differences between output-producing industries with respect to the "knock-on" effects of regulation of network and service sectors are largely accounted for by the business services, retail distribution and transport sectors.

Impact of regulation in non-manufacturing sectors on other industries, 2003[1]

The scale of the indicators is 0-1 from least to most restrictive



1. Average of OECD countries. The food industry includes food, beverages and tobacco. Computing includes the design, operation and maintenance of computer systems and software development.

Source: OECD, Product Market Regulation database and Conway and Nicoletti (2006).

StatLink: *http://dx.doi.org/10.1787/125662085583*

Competition-restraining regulations and productivity developments

Since the mid-1990s, labour productivity has accelerated in lightly-regulated economies but either accelerated more slowly or decelerated in highly-regulated countries that are behind the frontier (Figure 5.3). The new OECD empirical analysis shows that competition-restraining regulations slow the rate of catch-up with the technological frontier, where labour productivity is the highest.[2] By implication, countries could have achieved significantly faster productivity growth over the 1995-2003 period if they had aligned their regulations in each non-manufacturing sector on the least constraining stance in the OECD area in that industry (Figure 5.4).

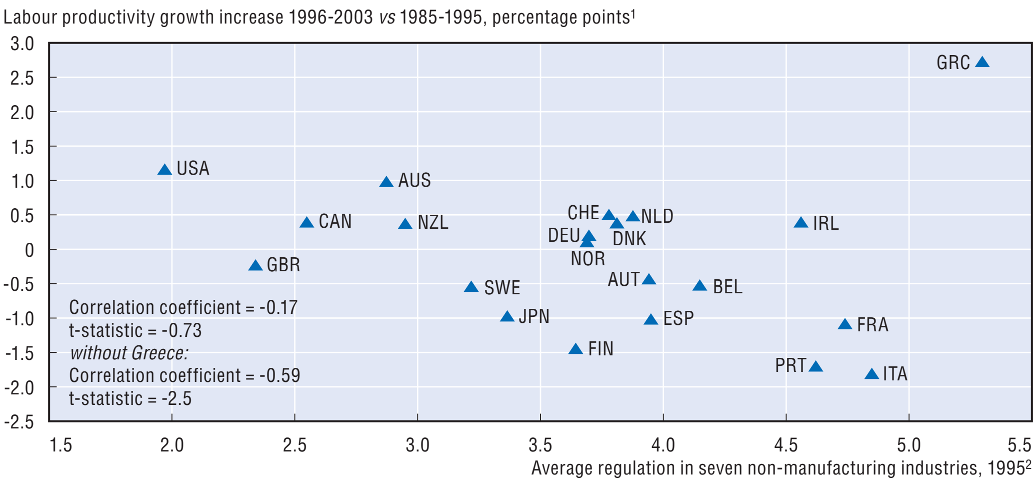
The greatest improvement in productivity growth would have taken place in countries with the most restrictive product market regulation, or those with the lowest productivity and hence the greatest scope to catch up towards the frontier. The average annual growth rate of productivity would have been boosted by at least ¾ of a percentage point in Canada and many Continental European countries. By contrast, gains would have been smaller for economies that are both relatively lightly regulated and close to the technological frontier, such as the Netherlands, Sweden, the United Kingdom and the United States, which already enjoyed strong productivity performance due to their favourable regulatory regimes. Overall, the observed divergence in productivity levels after 1995 would not have occurred if regulation in non-manufacturing sectors had been aligned in all countries to where it was least restrictive.

The channels from restrictive regulation to slower diffusion

Competition-constraining regulation can affect the speed of adoption of new technology in different ways. This section considers two channels. The first is by limiting investment in equipment that embodies the latest technologies. The second is via the negative impact that regulation has on FDI, which encourages the diffusion of technology internationally.

Figure 5.3. **Product market regulation and labour productivity**

The scale of the indicators is 0-6 from least to most restrictive

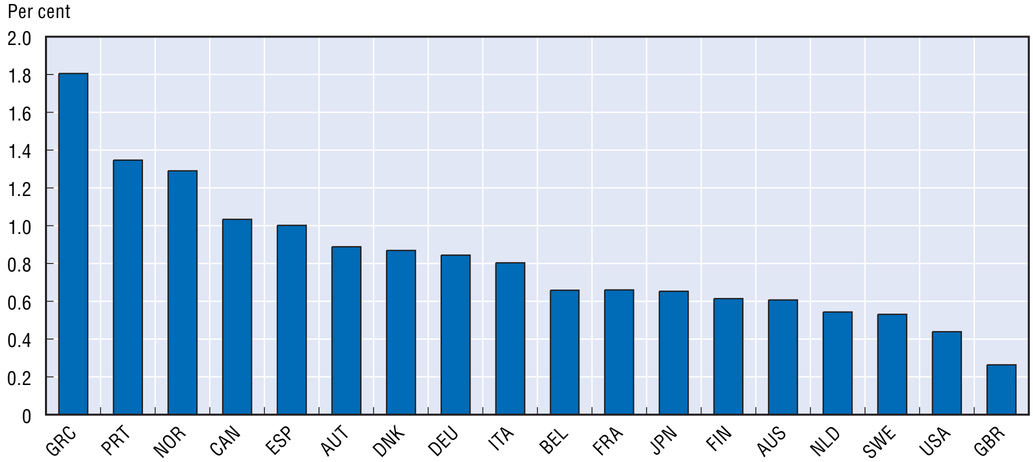


1. Labour productivity is defined as output per hour worked. In absence of sufficient retropolation at the time of publication, data for Greece do not take into account the 25% upwards revision to the level of GDP announced in 2006.
2. The seven non-manufacturing industries are airlines, telecommunications, electricity, gas, post, rail and road freight.

Source: OECD, Productivity and Product Market Regulation databases.

StatLink: *http://dx.doi.org/10.1787/038642343658*

Figure 5.4. **Potential increase of annual business sector productivity growth over the period 1995 to 2003 if regulatory stance least restrictive of competition had been adopted**[1]



1. Data are the average increase in annual business-sector productivity over the period 1995 to 2003 given an easing in the stance of regulation to the least restrictive of competition in the non-manufacturing sectors in OECD countries in 1995. The business-sector results are calculated as weighted averages of the sectoral productivity increases using value-added weights.

Source: Conway *et al.* (2006).

StatLink: *http://dx.doi.org/10.1787/268830617304*

Adoption of ICT

In the OECD, the share of ICT investment rose from 10% of total investment in 1985 to 20% in 2002. This masks striking variation across countries, depending in particular on how restraining their product market regulations were to competition. The ICT investment share was substantially higher in relatively lightly regulated economies, such as Australia, Finland, Sweden, the United Kingdom and the United States, than in Continental European economies (Figure 5.5). Relatively weak competition in some of the Continental European countries may have restrained ICT investment by protecting existing firms from the competition of new entrants exploiting cutting-edge techniques, or by making it more costly to acquire and integrate these new technologies successfully into the production process.

The OECD analysis confirms that product market regulation plays an important role in explaining differences in ICT investment across countries.[3] In the United States, relatively pro-competition regulations have boosted the share of ICT investment in total investment by more than four percentage points. In Australia, Canada and the United Kingdom, the estimated positive contribution of relatively light regulations to the share of ICT investment was between 2.5 and 3.5 percentage points. By contrast, in France, Greece, Italy, and Portugal, relatively restrictive regulations lowered the share of ICT investment by a similar amount.

Although it involves the whole economy, this negative effect can partly be traced to the heavy exposure of ICT-intensive sectors to restrictive regulation (Figure 5.6). Many of these sectors are subject to restrictive regulations themselves, but there are also often substantial further "knock-on" effects because they are also heavily dependent on inputs from other sectors, particularly services, that are tightly regulated.

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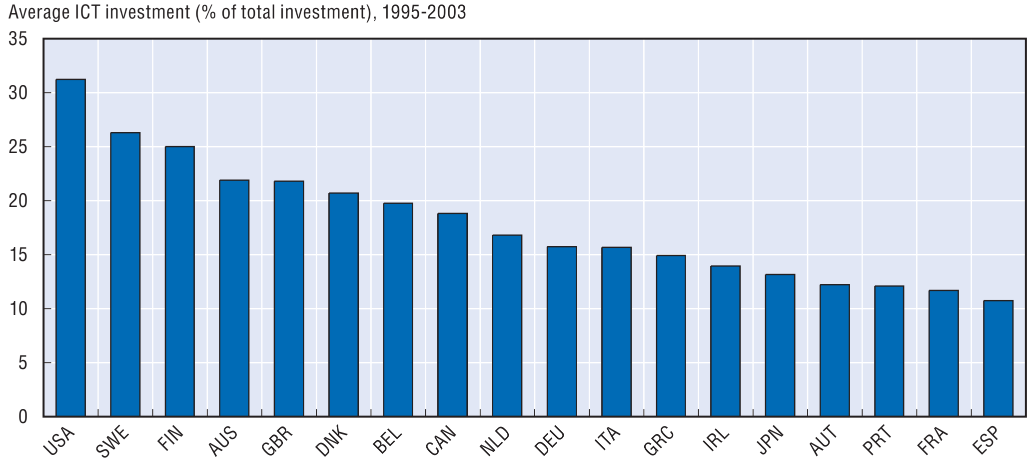
Figure 5.5. **ICT investment as a share of total investment, 1995-2003**

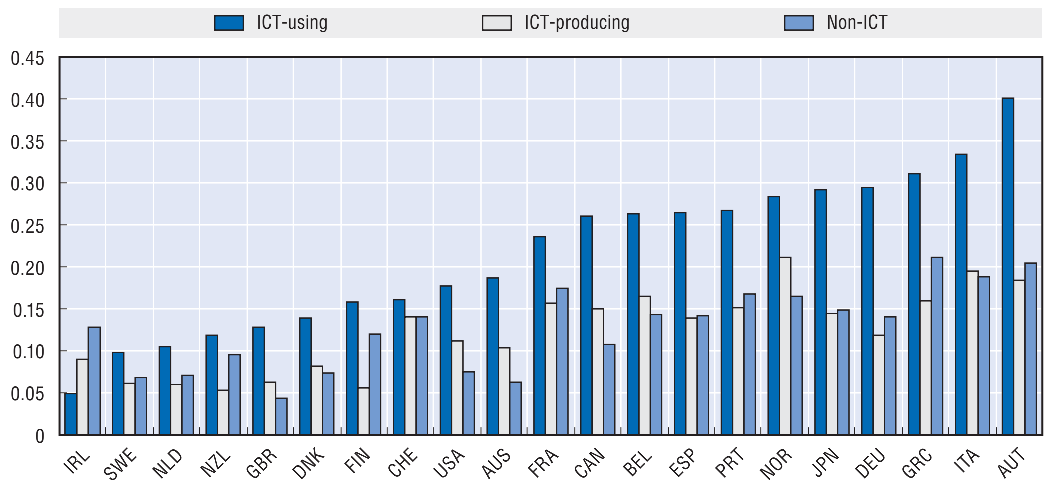


Source: OECD, Productivity database.

StatLink: *http://dx.doi.org/10.1787/301426688074*

Figure 5.6. **Impact of regulation in supplying sectors on ICT-producing, ICT-using, and non-ICT intensive sectors, 2003**[1]

The scale of the indicators is 0-1 from least to most restrictive



1. These data are the simple averages of the regulation impact indicators (see Box 5.1) for the individual industries included in ICT-producing, ICT-using, and non-ICT intensive sectors. The data are ordered according to the indicator values for ICT-using sectors.

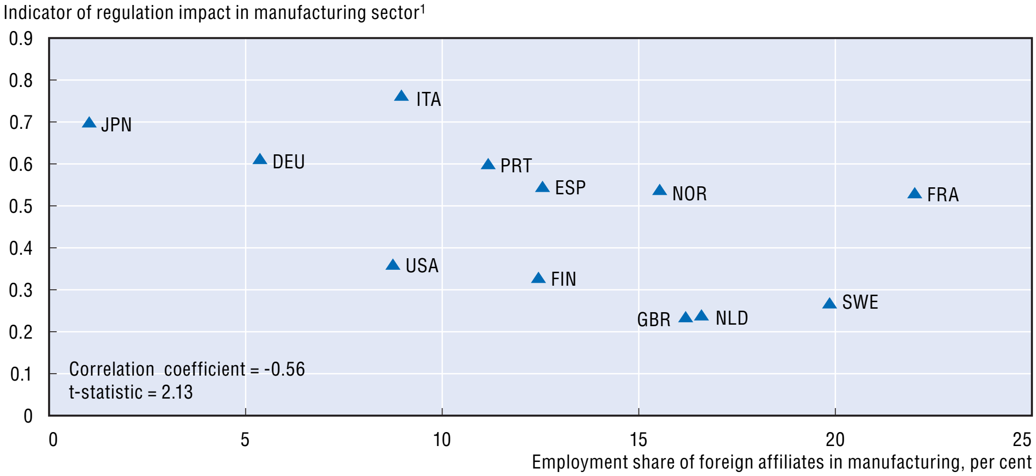
Source: Conway *et al.* (2006).

StatLink: *http://dx.doi.org/10.1787/804321013408*

Foreign direct investment

FDI is an important channel through which the use of technologies, such as ICT, spreads between countries. A firm acquiring or setting up a foreign business will bring some of its home know-how and management practices to the host country. Its entry, by intensifying competitive pressure, will also encourage local firms to adopt state-of-the-art technologies. Regulation can either hold back FDI through specific regulations on foreign affiliates and their access to the domestic market, or by a general regulatory environment that makes it harder for all new firms, including foreign ones, to enter the market.

Figure 5.7. **Product market regulations and the employment share of foreign affiliates in manufacturing, 1995-2003**



1. Simple average of the regulation impact indicators for manufacturing industries. The sample of countries shown is limited by the availability of data on the employment share of foreign affiliates in manufacturing.

Source: Conway *et al.* (2006).

StatLink: *http://dx.doi.org/10.1787/381560178384*

The importance of foreign affiliates in the economy differs significantly across OECD countries. Measured by their share of employment in manufacturing, it ranged from close to zero in Japan to over one-sixth in France, the Netherlands, Norway, Sweden and the United Kingdom (Figure 5.7). Within the manufacturing sector, there is a negative relationship across countries between the employment share of foreign firms and the strictness of regulation.

OECD empirical estimates confirm that regulations which restrict competition in the domestic economy deter the establishment of foreign affiliates. After taking into account other factors, one-tenth of the deviation of employment shares of foreign affiliates from the OECD average can be explained by the impact of product market regulations. Indeed, these general restrictions have almost as great an effect on the share of foreign affiliates in manufacturing as explicit controls on FDI.

The results imply that aligning product market regulation in each sector on the least restrictive of competition in 2003 would increase the share of total employment of foreign affiliates by over 3 percentage points for Austria, France, Italy, Japan and Norway (Figure 5.8). There would also be substantial increases for a number of other countries. Combined with an easing of direct regulations on FDI to the least restrictive setting, many OECD countries could nearly double the share of foreign affiliates in total employment and thereby give a strong impulse to labour productivity growth.

The positive impact on convergence of further regulatory reform

How much could productivity increase with further product market reforms? The potential benefits of further measures to enhance competition vary widely across countries, depending in part on the scope to make regulation less restrictive. Using the estimated relationships between anti-competitive regulations and productivity growth, simulations suggest that increases in labour productivity from adopting the least-restrictive regulations

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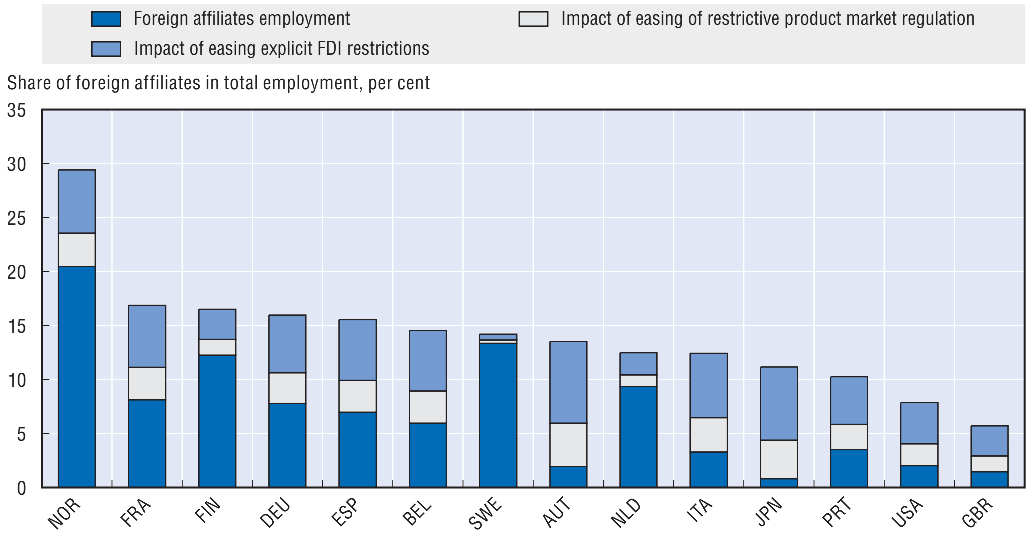
Figure 5.8. **Increase in the share of foreign affiliates in total employment following a move to sectoral regulations and FDI restrictions that are least restrictive of competition, 2003**[1]



1. Shows the effect of loosening competition-restraining product market regulations and explicit FDI restrictions to the level of the least restrictive in each sector. These results should be treated as indicative due to differences in the coverage between countries. The sample of countries shown is limited by the availability of data on the employment share of foreign affiliates in total employment.

Source: Conway *et al.* (2006).

StatLink: *http://dx.doi.org/10.1787/612618414465*

applied in each sector in 2003 would be substantial. Annual labour productivity growth over a ten-year period would increase by at least half a percentage point in Austria, Canada, France, Germany, Greece, Italy, Norway, Portugal and Spain. There would be smaller gains for countries that have either already liberalised regulations in non-manufacturing sectors and/or that have many sectors that are already close to the technological frontier. By raising labour productivity growth in countries further behind the technological frontier, this strategy would promote the convergence of productivity performance.

Notes

1. This chapter is based on Conway *et al.* (2006).
2. This effect is also emphasised by Aghion and Howitt (2005), and Aghion and Griffith (2006).
3. Other factors such as complementary investments in appropriate skills and organisational changes have also influenced ICT investment as discussed in detail in OECD (2004).

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Economic Policy Reforms
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PART II

Chapter 6

Policies to Strengthen Competition in Product Markets

In past decades, economic performance in most OECD countries has benefited from reforms of product market policies that have strengthened the intensity of competition in goods and services markets. Drawing on in-depth reviews in recent Economic Surveys *of individual OECD countries, this chapter takes stock of policies that influence competition, with a focus on the remaining obstacles to competition rather than on the progress achieved to date. It shows that enforcement of competition laws differs across OECD countries; regulations still limit competition in a number of sectors, notably in services; and the design of regulations in network industries does not always ensure access to networks or provide incentives to expand capacity.*

Introduction

The benefits for growth of competition in product markets have been highly visible in a number of sectors across OECD countries over the past decade or so and are increasingly recognised (see Box 6.1). This is reflected in reforms of general competition laws, increasingly pro-competition regulatory policies and greater openness to foreign trade and investment. Over the past few years, the OECD has conducted in-depth reviews of policies that influence the intensity of competition in over 20 member countries in the context of its regular *Economic Surveys* and identified recommendations to strengthen performance in this area.

This chapter reviews policies that influence competition in product markets, with a focus on the remaining obstacles to competition rather than on the progress achieved to date.[1] The next section discusses competition law, institutions and enforcement. The following sections address barriers to foreign trade and restrictions on foreign investment, and regulations in competitive and network industries. The description of policies in individual countries reflects the situation when the respective *Economic Surveys* were issued, and therefore has been overtaken by subsequent reforms in some cases.

The main findings can be summarised as follows:

- Competition laws prohibit horizontal cartels in most countries, but in some cases sanctions are below deterrent levels, the scope for private suits is limited and there are insufficient legal mechanisms to induce cartel members to defect. In a few countries, competition law is not applied to government-related entities and companies, which distorts competition with private companies.
- In several countries, regulations still limit competition in a number of sectors. In particular, this is the case in retail distribution and professional services, preventing potential efficiency gains *inter alia* related to economies of scale, trade in services and labour mobility.
- In network industries, the major remaining challenges are how to create a level playing field between firms of different ownership (*e.g.* domestic and foreign, public and private) in particular with respect to access to networks and how to provide investment incentives for owners of newly-privatised public monopolies.

Competition laws and their enforcement

Competition laws are broadly similar across OECD countries. What differs widely, however, are the institutions and methods for applying the competition law. Most OECD countries have revised their competition laws over the past decade, in particular to strengthen sanctions and enforcement powers. An indicator that summarises major elements of competition law and enforcement (and some aspects of network regulation) is presented in Box 6.2.

Box 6.1. **The impact of competition in product markets on economic growth**

Competition affects growth directly by boosting productivity, including by enhancing innovation and improving the allocation of production factors across the economy. It also strengthens growth by increasing employment.

Enhanced competition induces producers to supply what consumers want at the lowest cost, and hence results in labour and capital resources being employed where they make the greatest contribution to welfare. At the same time, it may also stimulate managerial efforts as there are more firms to serve as reference for comparison and the threat of bankruptcy is more credible (Nickell, 1996), thereby reducing the slack in the use of labour and capital.

An even more important, albeit more debated, channel than these one-off effects is the impact of increased competition on the growth of productivity, which works via enhanced innovation. While the positive effect of innovation on growth is well established in the literature (*e.g.* see Bassanini and Scarpetta, 2001 and Ahn, 2002), there has been some controversy about the effect of competition on innovation. According to some, competition may be detrimental to innovation, owing to the reduction of monopoly profits that would reward successful innovators. Others claim that competitive pressures enhance efforts to innovate and to diffuse innovation.

Striking the right balance between under- and over-protecting innovators' efforts will create incentives to innovate as well as ensure competition. The empirical evidence, including OECD work (*e.g.* see OECD, 2003; Nicoletti *et al.*, 2001; Bassanini and Ernst, 2002; Nicoletti and Scarpetta, 2003; and Scarpetta and Tressel, 2002), tends to be more in favour of the positive effect of competition on innovation. However, the impact of competition may depend on how far a country or an industry is from the technology frontier. At the technology frontier, competition may be more important both because it stimulates entry and forces firms to innovate in order to survive (Acemoglu *et al.*, 2002). For instance, heightened competition may lead to more innovation because it reduces monopoly profits prevailing before the innovation more than those that arise following the innovation (Aghion and Griffith, 2005). As discussed in Chapter 5 in this volume, recent OECD research finds that stronger competition has particularly powerful effects on productivity in countries far away from the technological frontier, reflecting stronger incentives to adopt new technologies.

Increased competition may also boost growth by stimulating employment through various channels. More intense competition leads to lower profit margins and prices that increase both output and employment. As well, it implies more entry and exit, and hence more job turnover, thereby increasing the likelihood of match between job seekers and employers. Greater competition in product markets may also enhance employment by making more immediately obvious the risk of job losses associated with overly high wages. This induced wage moderation will lead to lower unemployment (Blanchard and Giavazzi, 2003 and Nicoletti and Scarpetta, 2005).

The general framework of competition law

General competition laws set rules for the treatment of restrictive agreements, abuse of dominant market positions and mergers in most business activities (Table 6.1):

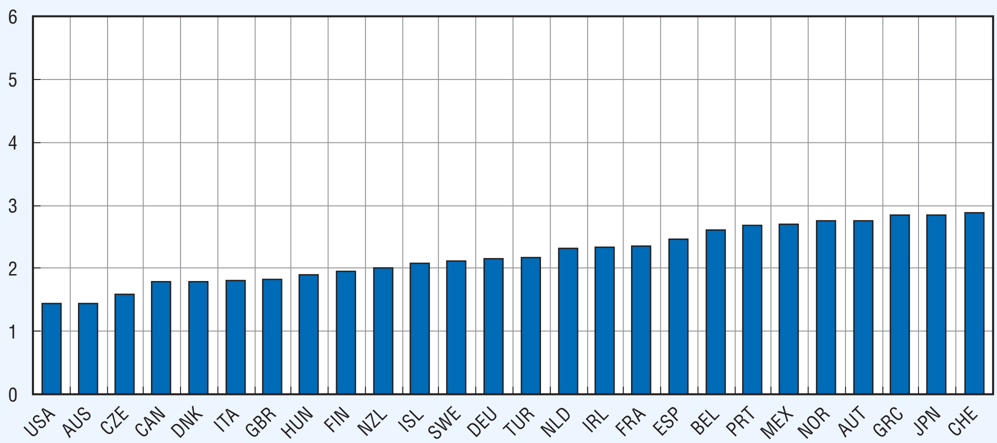
- *Horizontal price-fixing agreements*, which are the most likely to harm competition, are generally prohibited. In most countries, the law includes *per se* rules, which presume that these agreements harm competition. However, in a few countries, the enforcement agency must demonstrate how each particular agreement actually harms competition.

Box 6.2. **The competition law and policy indicator**

The competition law and policy (CLP) indicator summarises various aspects of general competition law and its enforcement, and policies that affect competition in selected network industries, as of 2003. The major component of the indicator includes the scope of the competition law, the effectiveness of its enforcement and the degree of independence of the competition authorities. The other component, policies affecting competition in network industries, which carries a much lower weight, comprises the independence of sector regulators and access issues.

The above sub-components can be disaggregated into lower-level indicators covering various aspects of major issues discussed in this section, such as the legal framework, merger regimes, exemptions and enforcement. All these aspects are assigned scores between 0 and 6, with 6 designating an overall framework least conducive to competition. Then these scores are aggregated into higher-level components, with weights at each level of aggregation based on the assumed importance of the sub-component. The indicator's sensitivity to different weighting patterns and the robustness of cross-country comparisons is tested by means of a "random weights" technique commonly used for testing indicators at the OECD (see, for instance, Conway *et al.*, 2005). It shows that the countries, or group of countries, at the opposite ends of the spectrum differ significantly with respect to policies safeguarding competition.

The competition law and policy indicator, 2003[1]



1. Indicator scale of 0-6 with 6 designating an overall framework least conducive to competition.

Source: Høj *et al.* (2007), forthcoming.

StatLink: *http://dx.doi.org/10.1787/600538020544*

- "*Vertical*" *agreements* on resale prices and other restrictions (such as exclusive dealing or territorial assignments) may also restrain competition, particularly where a vertical agreement is the means of enforcing a horizontal cartel. However, constraints on maximum resale prices can also be used to prevent the exercise of market power at the wholesale or retail levels, so in some countries only agreements setting minimum resale prices are prohibited. For most other vertical agreements between suppliers and customers, competition enforcers are moving away from prohibitions towards more nuanced rules, and even case-by-case assessment of actual effects on efficiency and competition. This more market-oriented approach is supported in some countries (such

Table 6.1. **Selected elements of the legal framework, 2003**

	Horizontal price fixing	Resale price agreements	Other restrictive agreements		Merger regimes	
	Prohibited by *per se* rules[1]	Prohibited by *per se* rules[1]	Threshold for market share or turnover (*de minimis* rule)	Market power test	Thresholds for minimum level of concern	Threshold for intervention
Australia	Y	Y	N	N	Y	–
Austria	–	Y	–	–	–	Y
Belgium	N	N	Y	Y	–	–
Canada	N	Y		Y	Y	n.a.
Denmark	Y	Y	Y	Y	Y	Y
Finland	Y	Y	Y	Y	–	–
France	Y	Y	Y	Y	–	–
Germany	Y	Y	Y	–	Y	Y
Hungary	Y	–	Y	Y	–	–
Iceland	Y	Y	Y	–	–	–
Ireland	–	Y	–	Y	Y	–
Italy	Y	–	–	Y	–	–
Japan	Y	Y	–	–	Y	–
Korea	Y	Y	N	Y	–	Y
Luxembourg	–	–	–	–	–	–
Netherlands	Y	Y	Y	Y	Y	–
New Zealand	Y	Y	N	Y	Y	–
Norway	Y	Y	N	N	Y	–
Sweden	Y	Y	Y	–	Y	Y
Switzerland	Y	–	Y	N	Y	–
United Kingdom	Y	Y	Y	Y	–	–
United States	Y	Y (minimum)	–	Y	Y	Y
European Union	Y	Y	Y	Y	Y	–

Note: "Y" stands for yes, "N" for no and "–" mark is assigned when there are additional circumstances that need to be taken into account.
1. No need to show effect or intent in the particular case.
Source: Høj *et al.* (2007), forthcoming.

as many of the European Union member states) by competition laws that include *de minimis* or *bagatelle* provisions to avoid wasting enforcement resources on trivial, purely technical cases, as well as to permit what are often efficient joint ventures.

- *Abuses of dominant positions* are subject to different approaches across OECD countries. In most countries, it can be a violation of the competition law for a dominant firm to exploit its market power in setting prices. But some countries do not treat that as a competition law violation, reasoning that high profits arising from market power may stimulate entry.
- *Merger regimes* across the OECD are converging both in substantive standards and in reviewing procedures, although some differences remain in the treatment of market dominance and claims about efficiencies. The European Union guidelines require assessing the effect only on competition, taking into account efficiencies as part of the assessment. They set thresholds for market shares and concentration ratios of the merged entity above which competition is potentially at risk and therefore where further investigation is needed. The approach is similar in Canada, New Zealand and the United States, except that mergers are not challenged if there are no barriers to entry and the strengthening of a dominant position is tolerated as long as it results in efficiency gains.

- *Exclusions from competition law* for some sectors and state-owned companies may hamper competition. Special treatment of certain sectors, such as network industries, is typically justified on the grounds of consumer protection, security of supplies or universal service provision. In a few OECD countries, such as Australia and the United States, public corporations are exempt from competition law. The over-ruling of competition law by other laws and regulations is a particularly important issue in federal countries, where individual states often enact regulations in order to protect local incumbents from competition.

Enforcement

The effectiveness of competition authorities in safeguarding competition depends on their degree of independence from political intervention, and on their relationship with sectoral regulators:

- Most OECD countries guarantee the *independence of competition authorities* through a variety of means. But where some members of the decision-making body are designated by social partners and interest groups (as in *e.g.* Austria, Denmark and Switzerland), accountability and transparency may be obscured.
- In general, *merger decisions* based on broad or public-interest criteria are more prone to non-transparent *ad hoc* interventions that weaken the application of the competition law, as compared with merger regimes that focus only on competition effects. This may particularly be the case in countries where decisions to authorise or even investigate mergers are taken by a government department rather than the competition agency (*e.g.* France and Norway). In some countries (*e.g.* Germany), merger decisions by competition authorities can in principal be overridden by the government on the grounds of other policy goals.
- The role of *sectoral regulators* and competition authorities in enforcing competition must be clearly defined. Depending on whether competition authorities maintain a regulatory role or not, there may be duplication of enforcement or lack of horizontal co-ordination. Deciding on the appropriate structure is difficult because sectoral regulators have more sector-specific knowledge than their multi-sector counterparts, but are also more prone to fall prey to regulatory capture. An intermediate structure is one where sectoral regulators are placed as units within the competition authority (*e.g.* Netherlands).

Credible sanctions are needed to deter hard-core cartels. Financial sanctions have been increasing in many countries, but they may still not be high enough to deter. In some countries, statutory caps (Figure 6.1) keep them lower than the likely gains from price fixing. Even when the law allows for higher sanctions, courts may be reluctant to impose them (*e.g.* Denmark, Finland) as this may affect the financial viability of companies. The additional deterrent of personal sanctions against individual managers is not used in many countries, and the scope for private suits is limited. Leniency programmes, offering lower penalties to whistle-blowers, have been found to be effective in detecting cartels, especially if sanctions are tough, but such programmes need to be carefully designed to be effective.[2]

Restrictions on foreign competition

Competitive pressures may increase through stronger foreign trade and investment. Indeed, for many countries, competition from abroad can be the most potent way to ensure competition in goods and services markets that can be exposed to international trade. Trade restrictions, including tariffs and non-tariff barriers, have been substantially

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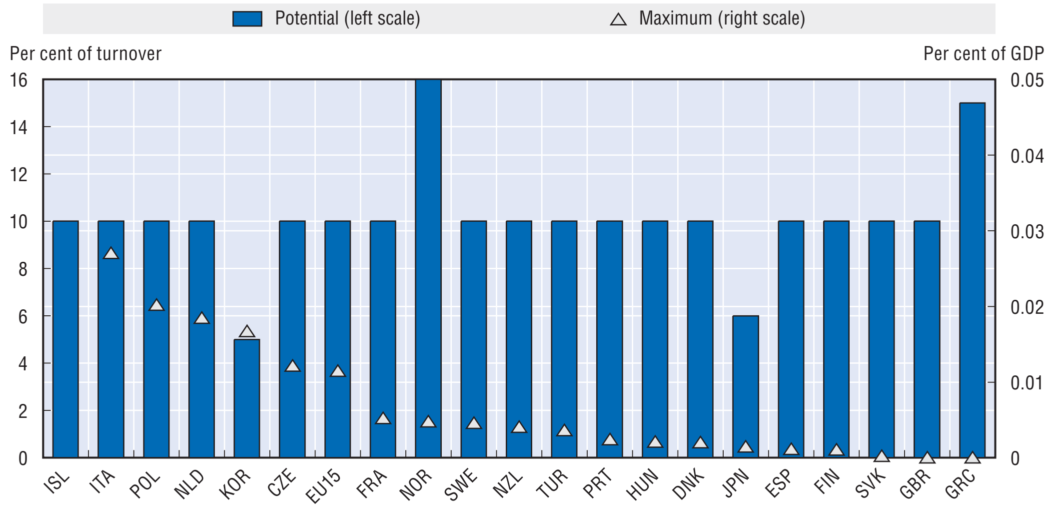
Figure 6.1. **Potential and actual maximum financial sanctions imposed on horizontal cartels, 2003**[1]

Potential sanctions as a share of turnover and maximum applied sanction as a share of GDP



1. In Norway, the statute sets no limit on potential financial sanctions. The value for maximum sanctions actually imposed in Iceland is the highest in the OECD area (0.18% of GDP) and is not shown because of scaling. In Japan, the potential sanction on large manufacturers was increased to 10% of turnover as of 2006. In missing countries, either potential sanction is not defined as a percentage of turnover or no data are available.

Source: Høj *et al.* (2007), forthcoming.

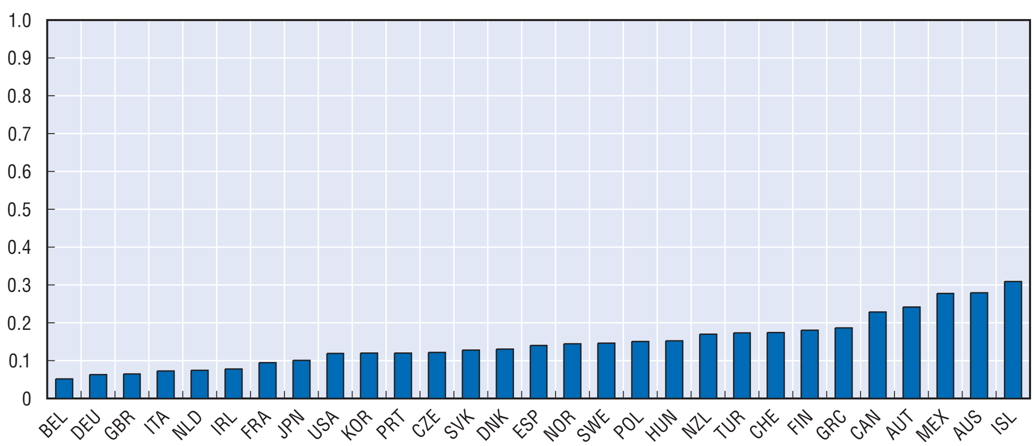
StatLink: *http://dx.doi.org/10.1787/863324464860*

reduced, with the exception of agricultural products, where heavy support of domestic producers discriminates against foreign competitors.[3]

Foreign direct investment (FDI) is particularly important to inject competitive pressures in non-manufacturing markets sheltered from cross-border trade. The indicator of restrictiveness of FDI shows that there is a large variation across countries in terms of their treatment of foreign investment (Figure 6.2).[4] Many OECD countries maintain ownership restrictions in network industries, in particular telecommunications (Australia, Canada,

Figure 6.2. **Foreign direct investment restrictiveness indicator, 2006**

Indicator scale of 0-1 from least to most restrictive



Source: Koyama and Golub (2006).

StatLink: *http://dx.doi.org/10.1787/018408861704*

Japan, Korea and New Zealand), energy (Iceland, Italy and Norway) and air transport (Canada, Iceland, Japan, New Zealand and the United States). In addition, some countries hinder foreign participation in other industries, such as real estate (New Zealand), the media (*e.g.* Canada and the United States) and fisheries (Iceland and Norway).

Regulatory barriers to competition

Regulations that limit entry and raise the cost of doing business weaken the intensity of competition. Such regulations are now found mostly in the non-manufacturing sectors. In some inherently competitive sectors, including retail distribution and professional services, such regulations have aimed at goals of public policy other than the promotion of competition. In other sectors, regulations have been applied because competition has not been possible for technical reasons, at least in some activities.

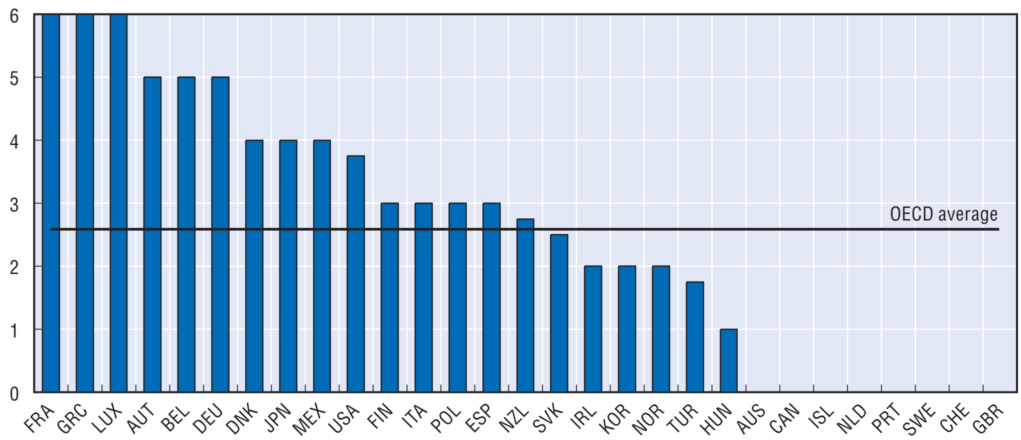
Competitive sectors: retail distribution and professional services

Increased competition in retail distribution has a strong potential to boost growth, as a better exploitation of economies of scale and scope enhances productivity. Indeed, recent large-scale consolidation and vertical integration in the retail sector has boosted productivity in most OECD countries. Nonetheless, some forms of regulations remain pervasive in many countries:

- Regulations of large-surface outlets are particularly strict in some Continental European countries, whereas they are absent in other countries (Figure 6.3). Their stated aims are typically urban development objectives, such as continued presence of small shops in city centres, environmental concerns and traffic limitations. Evidence, however, suggests that small shops still survive because consumers are willing to pay higher prices for their services (Dobson and Waterson, 1999). Furthermore, environmental and congestion issues could be addressed through more efficient instruments than restrictions on large-format outlets.

Figure 6.3. **Retail distribution: Special regulations of large-surface outlets are in place in most OECD countries, 2003**

Indicator scale of 0-6 from least to most restrictive



Source: OECD, Product Market Regulation database.

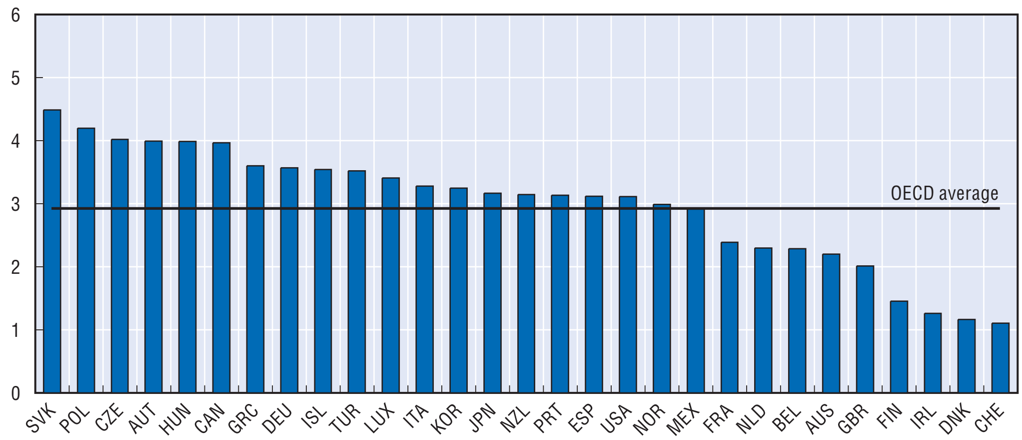
StatLink: *http://dx.doi.org/10.1787/547258155456*

- Shop-opening hours have been fully liberalised in several OECD countries, but remain restrictive in some European Union countries, Australia, Norway and Switzerland.
- A few countries maintain monopolies in the distribution of products such as alcohol (*e.g.* Finland, Norway and Sweden), tobacco (*e.g.* France), and newspapers and magazines (*e.g.* France) and Australia in the exports of wheat. The non-economic objectives pursued by these monopolies could be better attained by more targeted means.
- Reselling products "below cost" would not harm consumer welfare unless it led to less choice for consumers. Nevertheless, it is restricted even in the absence of such detrimental effects in *e.g.* Belgium, France, Germany, Hungary and Japan.

Professional services (*i.e.* accounting, architectural, engineering and legal services) are subject to a wide range of regulations in most OECD countries. Some qualification-related entry rules may be legitimate and even efficient in order for consumers to obtain low-cost assurance about the competence of service providers. While entry controls are common in the OECD area, the stringency of regulation varies significantly across countries (Figure 6.4), suggesting that in many countries entry in professions is more restricted than is needed for consumer protection or market integrity.

Figure 6.4. **Professional services: Entry regulations show a large variation across OECD countries, 2003**

Indicator scale of 0-6 from least to most restrictive



Source: OECD, Product Market Regulation database.

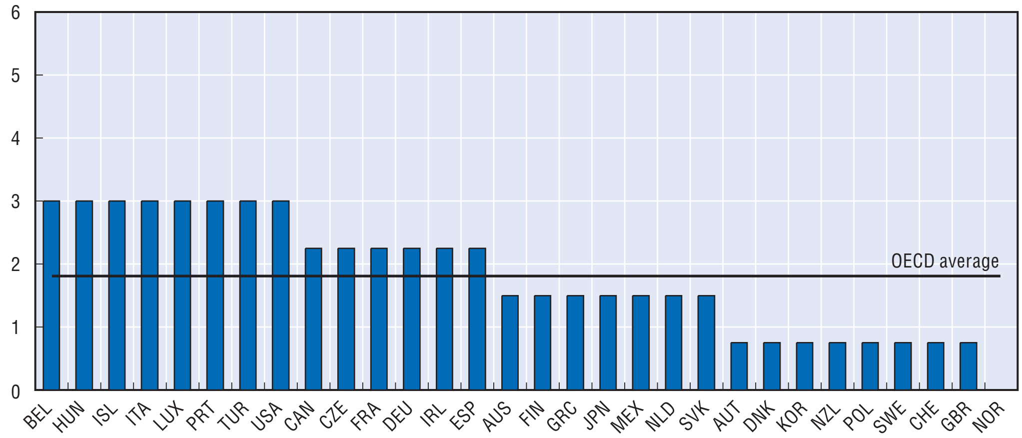
StatLink: *http://dx.doi.org/10.1787/453244387755*

There is little empirical evidence to suggest that the pervasive set of restrictions applied to professional services in many countries improves consumer welfare (Paterson *et al.*, 2003). In fact, such restrictions have been correlated with higher prices and less innovation without improving service quality:

- Extensive self-regulation by professional bodies may have detrimental effect on consumer welfare. The evidence reported in the *Economic Surveys* shows that the role of self-regulatory bodies often extends beyond the assurance of service quality and that they tend to exploit their position to overcharge for their services. In the extreme case they restrict entry, safeguarding the interests of incumbent firms to the detriment of customers. Licensing requirements established by professional bodies can be especially harmful as they limit the supply of services and are often associated with higher charges.

Figure 6.5. **Advertising of professional services is still heavily restricted in some OECD countries, 2003**[1]

Indicator scale of 0-6 from least to most restrictive



1. Average of accounting, architecture, engineering and legal services.

Source: OECD, Product Market Regulation database.

StatLink: *http://dx.doi.org/10.1787/022503576235*

- Advertising is sometimes prohibited (Figure 6.5) on the grounds that it distorts consumer choice in conditions where consumers have difficulties in selecting a provider owing to the specific nature of professional services. Evidence, however, shows that restrictions on advertising increase the fees charged for professional services (Paterson *et al.*, 2006). Bans on advertising have been lifted for a few services in some OECD countries.
- Heterogeneous regulations across jurisdictions can create obstacles to trade in services and mobility of professionals both across and within countries. The trade-hampering effect is found to be important in *e.g.* Australia, Canada, the European Union, Switzerland and the United States. In several countries, the easing of residency or nationality requirements would encourage labour mobility of professionals. In the European Union, there is a programme to remove barriers to the mobility of professionals across member states.

Network industries

Striking the balance between regulation and competition is particularly important in network industries, such as telecommunications, electricity, air and rail transport, given their importance in the economy. Regulation of some segments of network industries is necessary to prevent monopoly abuse, but in other segments competition should be feasible. In practice, the degree of regulation varies across industries and countries. Some of the challenges in injecting competition into traditional utility industries – where a non-competitive segment of the industry (*i.e.* fixed telephony network, transmission grid or rail tracks) is vertically integrated with a potentially competitive segment – are similar for most of these sectors. Beyond these common issues, some of the specific sectors face particular problems.

Common issues across sectors

Securing non-discriminatory third-party access to the network is crucial to induce competition in the competitive segments of network industries. In most countries, non-discriminatory access has been sought by separation of the network segment from other components and regulation of access charges. However, the extent of separation of vertically-integrated companies has differed across countries. Accounting separation has been most common, making cost information readily available for setting non-discriminatory access prices. However, this type of separation may not be sufficient to ensure non-discriminatory access for two reasons. One is that the regulator and the incumbent are in a different position with respect to information; the other is the lack of capital accounting for government-owned incumbents (*e.g.* France, Japan and Norway). Management separation has provided a stronger distinction between units and legal separation creates a distinction between companies, but only ownership separation can ensure that the natural monopoly network segment no longer has incentives to favour its affiliates over alternative providers.

Ensuring the right incentives for investment in network industries in a more market-based environment is a common challenge for regulators. Capacity expansion may not be in the interest of a network owner if expansion undermines his capacity to charge high prices. Appropriate price regulation can, in principle, help to stimulate investment in new capacity by ensuring adequate rewards. However, deficient price regulation can seriously depress capacity, as was the case in the electricity industry in California and Ontario, where retail prices were capped and rising wholesale prices therefore put pressure on the profitability of distributors which was reflected in low investment spending. Insufficient incentives for investment may also arise when parts of network industries are franchised and the franchising period is relatively short.

The financing of the costs of universal service obligations in network industries has become an issue, given that in more competitive markets they can no longer be financed through traditional cross-subsidisation from profitable market segments. Country experiences suggest that the appropriate financing mechanism depends on the number of network users and distributional effects. Compensation for the cost of universal service obligation may be financed from universal service funds to which companies contribute (*e.g.* energy and telecommunications in France, and telecommunications in Austria, Germany, Italy and Japan). However, some countries consider that there are enough benefits from universal service (in terms of image, of gaining potential profitable consumers, etc.) to compensate for the cost without requiring additional financial support. Where compensation is considered appropriate, the levels of compensation are set by competitive tendering (*e.g.* Denmark and Germany).

Public ownership and state control of network industries has declined in most OECD countries in recent years. With an increasing share of private competitors in network industries, the main issue has become how to ensure a level-playing field between state-controlled enterprises and private firms on the one hand, and between domestic and foreign firms on the other hand. Experience shows that it is crucial that all firms operate in the same legal and regulatory environment regardless of ownership. As noted earlier, in some countries (*e.g.* Australia and the United States), government-related entities are excluded from competition law. In other countries state guarantees (*e.g.* France and Ireland) and favourable tax treatment of public companies (*e.g.* France and Japan) distort competition.

Weak regulatory power or insufficient degree of independence of sectoral regulators may hinder the creation of a level playing field between competitors. When public ownership is dominant in both the network and the competitive segments of the market, it is particularly difficult to establish independent regulation, as the government is both owner and regulator (*e.g.* Australia, Canada, France and Germany).

Sector-specific issues

Telecommunications.[5] Opening up the competitive segments to new entrants, together with huge technological progress, have brought about lower telecommunications charges across OECD countries. A major challenge remains how to prevent the operator of the network from restricting competition in the competitive segments. Separation (accounting or management) of the non-competitive segment from competitive segments does not by itself guarantee non-discriminatory third-party access to the trunk network if access prices are not regulated. High access prices have been found to hinder potential competition in *e.g.* Australia, Finland, Hungary, Iceland, Ireland, Norway and Switzerland. A common way to encourage competition has been through the unbundling of the local loop (*i.e.* allowing competitors to use the incumbent's local network), which has been promoted in most OECD countries. Progress in competition between local networks (*i.e.* through building competing networks to that of the incumbent operator) has been more limited in most OECD countries, except in *e.g.* Australia, Denmark, Korea, United Kingdom and the United States. Intermodal competition, notably by mobile and cable service providers, has been crucial in increasing competition pressures in telecommunications markets. A key hindrance to competition is that mobile operators set the fees that other service providers pay to complete calls on their networks. The remedy for this may be price regulation on call termination charges.

Electricity. Competition in the electricity industry has been slow to develop, partly owing to the high degree of integration of the industry and the impossibility of competition between networks. The most important prerequisite for competition is separation of the transmission grid to prevent integrated generation and transmission companies from abusing their information advantages and discriminating in the provision of access to the grid. While a certain degree of separation has been secured in most European Union countries, utilities are still vertically integrated *inter alia* in Australia, Canada, Germany, Japan, Korea, New Zealand, Spain, Switzerland and the United States. Separation of the distribution system from generation is also crucial for competition as it may ensure tariffs that reflect costs and the removal of cross-subsidies. Nevertheless, it may not be adequate to foster competition without a sufficient number of competitors in generation, since dominant utilities may affect electricity prices by restricting output, as has happened in the past in the Netherlands and the United States. Increased integration of domestic and international electricity markets has proved to be an important way of diluting the power of dominant domestic utilities.

Air transport. Competition in air passenger transport has emerged rapidly as a result of the removal of entry barriers. Deregulation has stimulated a myriad of innovative practices leading to higher productivity and lower prices: a system of air transportation in which local airports offer air transportation to a central airport where long-distance flights are available (the so-called hub-and-spoke system), thereby increasing flight frequency and the emergence of low-cost carriers. To cope with competitive pressure, some national carriers have cut costs and reduced prices on the most competitive segments of the market to match those of low-cost carriers, while others found strategic partners or gone out of business. Notwithstanding the recent intensification of competition in the industry, ownership and other restrictions related to access to airport slots and ground-handling and to domestic services still constitute a barrier to stronger competition. Restrictions on foreign ownership, limited access of foreign carriers to domestic airports or to domestic routes in the absence of multilateral open-sky agreements or cabotage rights reduce competition in most countries.

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Also, non-market-based allocation of landing slots (virtually all airports, one exception is Atlanta in the United States), provision of ground-handling services on a non-competitive basis (*e.g.* Belgium, France, Japan and Norway) and public ownership of airport infrastructure (*e.g.* Finland, France, Japan and Norway) hinder competition.

Railways. A certain degree of unbundling of vertically-integrated railway companies is desirable to induce competition, but careful design of reform is needed taking into account country-specific characteristics (such as possibilities for competition on parallel tracks and competition from other modes of long-distance passenger transport) to avoid regulatory failure. Efficiency gains in the sector have been achieved in many countries through reduced regulatory restrictions, notably by lowering entry barriers (*e.g.* Australia, Denmark, Italy and Switzerland) or improving market structures (*e.g.* Denmark, Germany, Italy and the Netherlands), especially in the freight business. Entry of alternative providers was made possible in *e.g.* Denmark, Finland, France, Italy, Germany, Hungary, Norway and Sweden by accounting or legal separation of the network. However, deregulation of the railway industry is controversial owing to the unresolved question of how to provide market-based investment incentives in the network segment of the industry. In particular, regulatory authorities in the United Kingdom have faced this problem after privatising the rail sector, because of the lack of clear assignment of responsibility of investing in tracks and the lack of incentives to invest in the rolling stock, partly owing to the short duration of franchise contracts.

Notes

1. This chapter is based on the synthesis of OECD country reviews on competition and product market regulation by Høj *et al.* (2007).
2. For example, such programmes need to be asymmetric (*i.e.* the first cartel member to come in and give evidence can count on getting much more lenient treatment than anyone who comes later) and transparent to encourage defection. Too little difference in the treatment of the first and subsequent defectors (as appears to be the case in *e.g.* Denmark and France) may undermine the critical incentive to be first. The promise of leniency may not be credible if the terms are uncertain or if it can be overruled by other bodies, as in *e.g.* Denmark and Ireland.
3. The agriculture sector, where several OECD countries maintain barriers to competition, is not covered in detail here.
4. The indicator comprises limitations on foreign ownership, special screening procedures which apply only to foreign investors and regulations related to the post-entry operation of foreign firms, such as those related to nationality of board composition and minimum domestic content.
5. Regulatory issues in telecommunications markets are discussed in detail in OECD (2006).

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Economic Policy Reforms
Going for Growth

PART II

Chapter 7

What Shapes the Implementation of Structural Reform?

Over past decades many OECD governments have devised structural reforms in product and labour markets aimed at enhancing competition pressures and productivity. Some of these reforms have been successfully implemented; others met strong political opposition and were aborted or postponed. This chapter draws on recent OECD empirical analysis that looked at past structural reform experience in member countries and sheds some light on the factors driving the political feasibility of reforms. It discusses how reform-minded governments can facilitate the implementation of the desired changes in policies and institutions through a careful design of the reform process.

Introduction

Governments throughout the OECD are committed to strengthen growth, employment and public finances. That the pursuit of these objectives requires in many countries extensive structural reform is also broadly recognised. Yet, progress has been uneven across both countries and policy fields. One reason for this arises from possible trade-offs with worthwhile non-economic objectives. However, differences in the depth, scope and timing of reform also reflect political constraints. Because reforms do not only increase overall welfare but also tend to alter its distribution across society, it has proved difficult to generate the necessary pro-reform consensus in the electorate. Better understanding the factors behind resistance to reform and finding the ways to overcome it are at the core of a new area for research, the so-called "political economy of structural reforms", a field that the OECD has recently investigated in some depth.

These political economy issues are the subject of this chapter, which provides a brief review of reform patterns in OECD countries before taking stock of recent OECD research on the way in which economic and political conditions can affect the course of reform in product and labour markets.[1] The chapter then draws some conclusions on the reform strategies that could improve the chances of successfully implementing growth-enhancing policies.

The bumpy road to structural reform

Progress in structural reform has been achieved in OECD countries over the past two decades (OECD, 2005, 2006a and Chapter 1). Over this period, the sequencing of reforms has generally seen reforms of trade, foreign direct investment and financial markets precede domestic product market reforms (IMF, 2004; Høj *et al.* 2006). Moreover, product market reforms have often preceded labour market reforms (Brandt *et al.* 2005).

However, reform progress has been unevenly distributed across countries and policy fields (Figure 7.1). Reforms have generally been extensive in product markets, where competitive pressures have been enhanced, but much more limited and hesitant in labour markets. Especially in large Continental European countries and Japan, labour market reforms mainly resulted in lower tax wedges and more flexible temporary contracts. These reforms often interacted with other policies – such as strict hiring and firing rules for other contracts – to generate labour market dualism, with highly protected jobs for some groups but precarious job prospects for others that have a weak attachment to the labour market (such as young workers and women). In product markets, the depth and pace of reform differed across countries and sectors, with a few countries (the United States and other English-speaking countries as well as some smaller European countries) beginning reforms before the mid-1980s and large Continental European countries pushing ahead with reform, to different degrees, only over the past decade (Figure 7.2). Moreover, while in many OECD countries certain non-manufacturing sectors (road freight, air transport) were opened up to competition early on, in other sectors (energy, postal services and railways) regulations still hinder competition, as documented in Chapter 6.[2]

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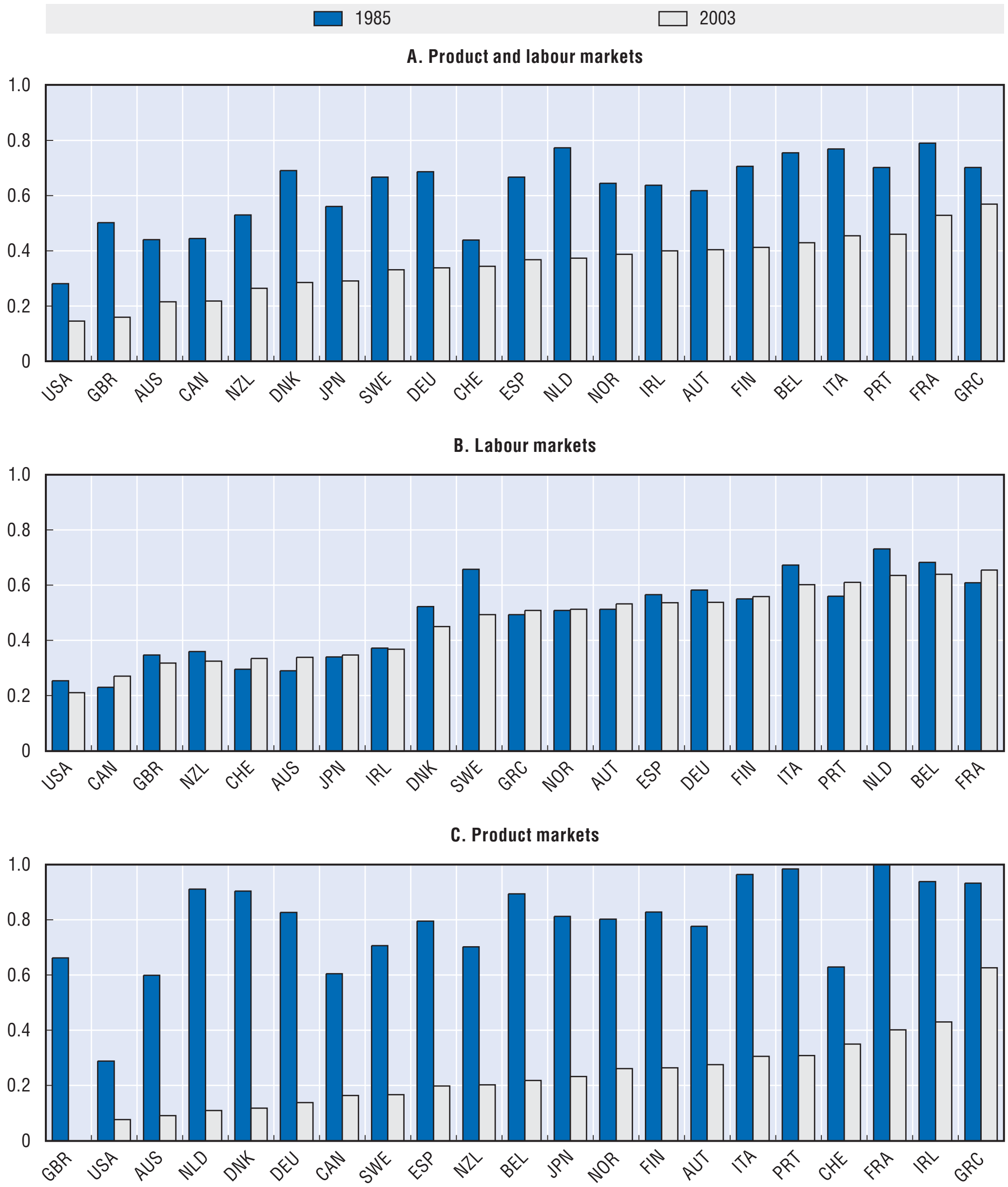
Figure 7.1. **Structural policy rigidities in 1985 and 2003**

Synthetic indicators of product and labour market policies[1]



1. The product market indicator covers competition-restraining regulations in energy, transport and communications sectors. The labour market indicator covers employment protection, benefit systems, implicit tax rates on continued work at older ages and labour tax wedges. All indicators are normalised ranging from 0 to 1, where 1 indicates the highest degree of rigidity. The overall indicator displayed in panel A is a weighted average of the indicators reported in panels B and C, with equal weights given to the two indicators.

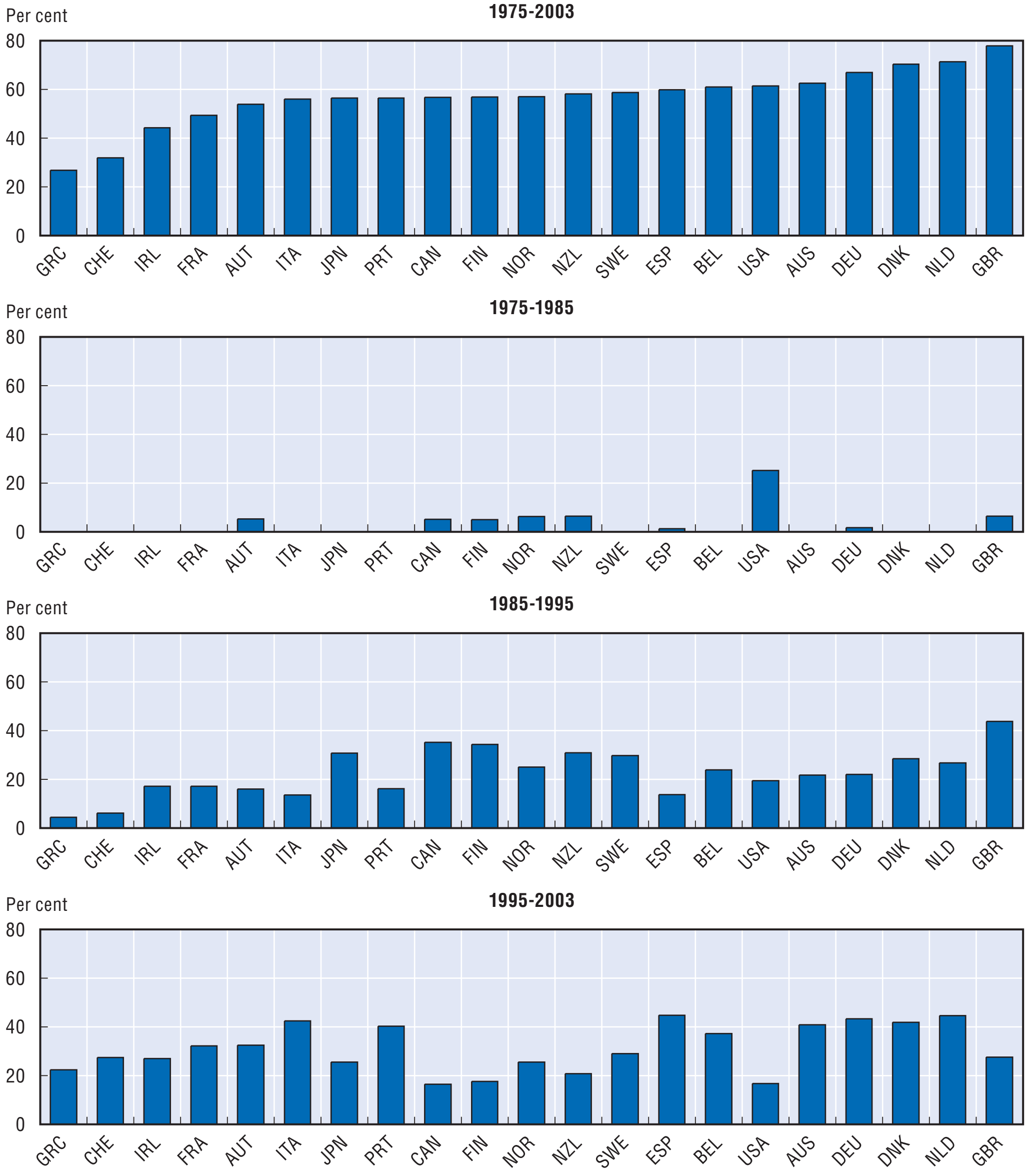
Source: Conway and Nicoletti (2006) for the product market indicator; Høj *et al.* (2006), for the labour market indicator.

StatLink: *http://dx.doi.org/10.1787/780362731086*

There are several reasons for these uneven reform patterns. Different initial conditions, collective preferences and – in the case of product markets – technology developments may have affected the feasibility and timing of reforms in different countries and sectors.[3] However, the most common explanation lies with the political difficulties met by reforms at the adoption and implementation stages. Indeed, even when

Figure 7.2. **Timing of product market reforms**

Percentage reduction in the stance of product market regulation[1]



1. As measured by the change in the indicator of product market regulation (defined in Figure 7.1). Countries are ranked according to their total reform effort over the 1975-2003 period.

Source: Conway and Nicoletti (2006).

StatLink: *http://dx.doi.org/10.1787/572518402821*

reform needs were clearly identified by the policy community, pushing them through often proved challenging. In a number of cases, especially during the 1980s and early 1990s, the need to combine structural reform with fiscal consolidation further complicated the task.

Political obstacles to reform are of two kinds. In some instances, economic efficiency goals may be seen to clash with the attachment to existing policies of individuals or groups concerned by reform. This attachment may relate to notions of fairness (as in protection against arbitrary job dismissal), security (as for unemployment insurance) and avoidance of disruption (as in policies to secure the supply of crucial products and services).

Sometimes the fear that reforms would endanger such values generates opposition also from groups that are not directly concerned by the change in policies. These concerns are especially acute when reform strategies include changes in income support schemes and hiring and firing rules.

Most often, however, it is the mismatch between the real or perceived costs and benefits of reforms that generates opposition to them. Reforms frequently entail highly visible costs concentrated on clearly identifiable groups of people (*e.g.* firms and workers incumbent in a sector or enjoying particular contractual arrangements) while benefits generally come later, may be seen as more uncertain, and are more widely diffused across society (*e.g.* among consumers or potential new job holders or businesses).[4, 5] Typically, those who feel they would lose from reform – either because it would dispel advantages created by existing policies (such as when legal monopolies are eliminated)[6] or because it would imply transitional costs (such as when job losses are temporarily involved) – pose the greatest political economy hurdles to reformers.

What influences the progress of structural reform?

While political difficulties in implementing reform are common, both their intensity and the ability of reformers to overcome them depend on a host of factors, which tend to shape the extent and course of reform in each country. Some of the factors influencing reform either cannot be controlled by the government or would involve undesirable collateral costs if they were exploited purposely. However, the ability to change the course of policy also depends on the way reforms are designed and implemented. The timing, scope and modalities of reform efforts as well as the interactions with macroeconomic policies, and among structural policies themselves, are levers that policy makers can use, in principle, to foster consensus around a structural reform agenda.

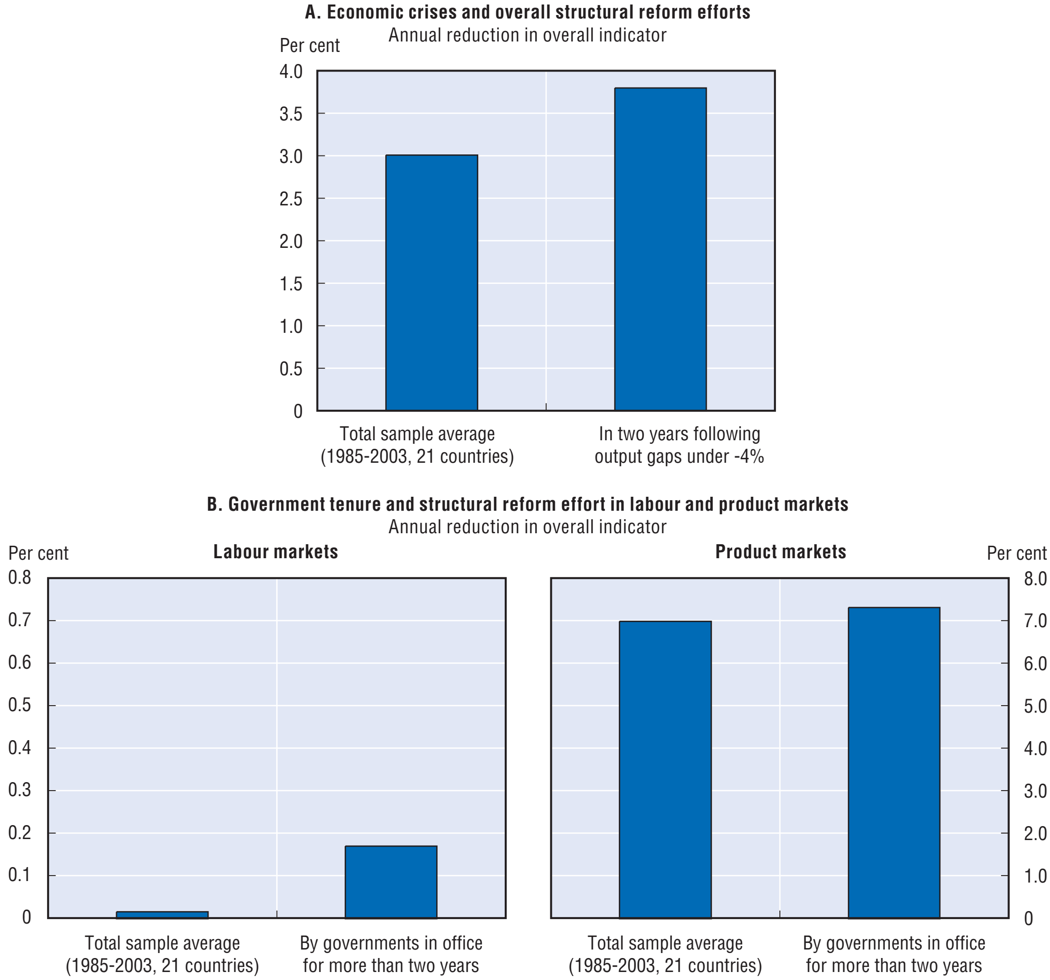
Some drivers of reform are outside the government reach

Deep economic downturns are typically associated with increased intensity of reform (Figure 7.3, Panel A). This observation is confirmed by cross-country empirical analyses showing that structural reform is often set off in times of crisis.[7] This may occur because crises weaken opposition to reform by exposing the unsustainability of existing policies. Country-specific examples include the United Kingdom at the end of the 1970s, the Netherlands and New Zealand in the 1980s, and Italy in the early 1990s. The influence of poor economic performance on reform implementation can be substantial: Duval and Elmeskov (2005) find that an output gap under –4% increases the probability of at least one major structural reform in product and labour markets by almost a third.[8] Of course, this empirical regularity is of little help to policymakers, insofar as experiencing a major crisis is hardly a productive way to promote structural reform. Even so, knowledge of the reform opportunities spurred by a deep downturn may be used to design a successful way out from an economic crisis.

Reforms are also conditioned by the political cycle. Given that the benefits of reform accrue with a lag whereas the costs typically arise upfront, the timing within the electoral period may influence a government's scope and appetite for change. In principle, the beginning of government tenure should be more propitious for reform. In practice, possibly reflecting political and execution lags, actual implementation of structural reforms in OECD countries has tended to gain momentum at mid-government term.[9] As shown in Figure 7.3 (Panel B), this has especially been the case for labour market reforms, perhaps reflecting the need to build up the necessary expertise. One implication is that political

Figure 7.3. **Crises, government tenure and progress in labour and product market reform**

Annual percentage reduction in synthetic indicators of labour and product market policies[1]



1. The indicators are described in Figure 7.1.

StatLink: *http://dx.doi.org/10.1787/556683764160*

stability tends to be a prerequisite for reform. In addition, empirical analysis indicates that, on average, governments classified as left-of-centre have been less inclined to implement those labour market reforms that, aside from their expected effects on economic efficiency, are perceived to have potentially adverse effects on equity (Høj *et al.* 2006).

Other factors escaping near-term government control that may have a bearing on the propensity to implement structural reforms are demographic developments and country size. However, their effects are less clear-cut. The effects of ageing on reform implementation are, in principle, ambiguous, but the limited available empirical evidence suggests that it could spur at least some kind of structural reform, especially in product markets.[10] Country size may also matter, with small countries sometimes found to undertake more reform, as in Continental Europe over the past two decades. Reasons for this could comprise greater population homogeneity, which may ease decision making, and greater openness to trade, which increases competitive pressures and eases concerns that structural reform could lead to imbalances between aggregate demand and supply (see below).

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Government policies can "grease the wheels" of reform

Monetary anchors and sound budgets may make reforms easier

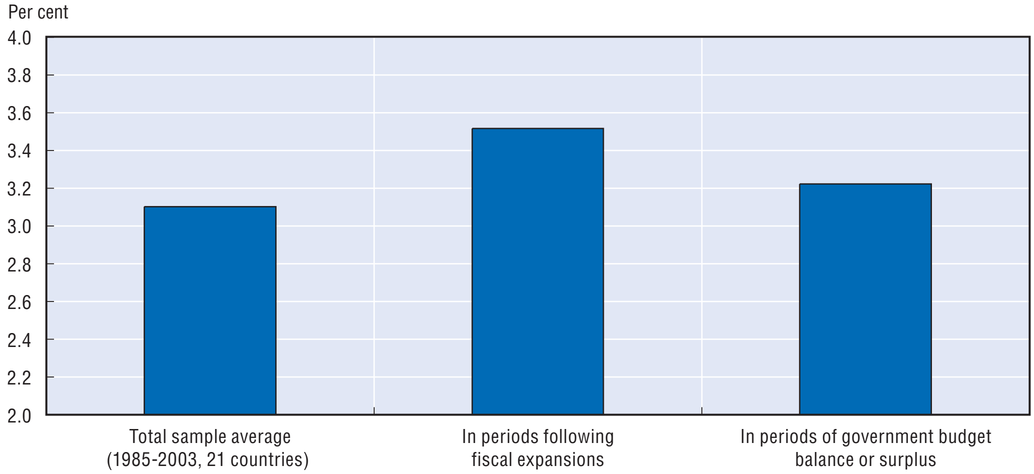
Macroeconomic policy plays a potentially important role in accommodating, and thus facilitating, structural reform. Such reform may alter the balance between demand and supply and monetary and fiscal policies have the potential to speed up the restoration of balance. For example, reforms that lower the structural rate of unemployment (NAIRU) and thereby expand potential output may not be accompanied by a corresponding immediate expansion of demand. Indeed, if structural reform increases uncertainty and precautionary saving, the opposite could happen.[11] Hence, it could take a while before actual unemployment falls to the level of the new, lower NAIRU. The prospect of such slow adjustment might discourage structural reform in the first place.

There are some reasons to believe that monetary policy could play a role in ensuring that aggregate demand and supply remain balanced in the wake of structural reform. Monetary policy anchored to a domestic target would ease if a widening margin of slack between supply and demand were to put downward pressure on inflation. Awareness of this "safety net" should in theory facilitate the implementation of structural reform.[12] Monetary policy geared to an external anchor – including exchange-rate targets, currency boards and participation in monetary union – cannot be expected to provide such a "safety net", unless reforms are coordinated among countries and deflationary pressures arise in the common currency (or exchange rate) area. Nonetheless, such external monetary anchors may increase the pressure to undertake structural reform.[13] This is because, for instance, competitiveness losses suffered by individual members of a monetary union will not, in general, be addressed by the union's monetary policy. Model simulations suggest that, in this context, incentives to reform would be particularly strong for small open economies, which would benefit most from the related competitiveness gains (Hoeller and Giorno, 2006). Empirically, there is no compelling evidence that an external anchor helps or hinders structural reform in general, but there is some indication that major structural reforms could be aided by monetary policy autonomy.[14]

While the evidence is mixed as to whether monetary policy influences structural reform patterns, there is stronger empirical support for the notion that fiscal policy can play a supportive role. The exact nature of the influence appears to differ across studies, however. One reason for finding a role for fiscal policy is that, like monetary policy, it can facilitate structural reform through the demand-management channel. This may explain why Høj *et al.* (2006) and Duval (2005) find that fiscal expansion is associated with more structural reform and contraction with less, an empirical finding which is illustrated in Figure 7.4. A similar reasoning may explain why these studies find that a healthy initial budgetary situation is associated with reform, notably in some labour market areas (such as benefit systems and labour tax wedges) – the scope for fiscal accommodation being larger when public finances are in better shape. Thus, while fiscal consolidation may make concomitant structural reforms difficult – notably because it draws on the political capital available to the government – it may prepare the ground for future reforms as budget balance is restored.[15] As illustrated by Figure 7.4, the quantitative impact of fiscal policy on reform may not be very large, with estimates suggesting that the likelihood of major reforms increases by 3 to 5% when a country improves its fiscal surplus by around 2 percentage points of GDP. Examples of this sequencing of policies are, for example, the experiences of Denmark and Ireland, which lowered labour tax wedges and liberalised product markets after extensive fiscal consolidation in the 1980s.

Figure 7.4. **Fiscal policy and progress in labour and product market reform**

Annual percentage change in synthetic indicator of labour and labour market policy[1]



1. The indicator is described in Figure 7.1.

StatLink: *http://dx.doi.org/10.1787/384388021641*

However, the empirical results concerning fiscal policy may reflect more than its role in demand management. In particular, overcoming the resistance of groups opposed to reform may require the payment of compensation or the "grandfathering" of existing policies, which may show up as fiscal easing and require sufficient scope in the government budget. Regardless of whether it is the demand-management or the compensation argument that explains the empirical link between fiscal policy and structural reform, the current environment of substantial fiscal deficits and consolidation needs would not appear to be very propitious for structural reform. That said, in the case of EU countries, the 2005 revision of the Stability and Growth Pact provides scope to overshoot the Maastricht deficit threshold to some extent in the case of structural reform, and therefore in principle allows fiscal policy to "grease the wheels" of such reform.[16]

Structural reforms may strengthen each other

As discussed in Chapter 4 and OECD (2006b), there is substantial evidence that liberalisation in some policy areas is associated with an increased likelihood of subsequent liberalisation in other areas. At a very general level, estimates suggest that the likelihood of reform in one area is increased by over 5% when reforms in other areas have already been implemented (Duval and Elmeskov, 2005). In principle, such policy inter-linkages could be exploited to move forward on structural reform – to the extent policy areas can be identified where progress is easier and where such progress then makes it easier to reform other policies. A few examples are provided below. Nonetheless, caution is warranted: conclusions from the empirical evidence essentially rely on establishing causal relationships from the average past experience of OECD countries, which may not necessarily apply in all cases.

Historically, liberalisation of international trade and financial flows has tended to precede other reforms.[17] This may indicate that reform in these areas are relatively easy to achieve – even if this may be less the case when such liberalisation has labour market implications or involves opening up control rights over enterprises to foreigners. Financial sector reform may prompt reforms in other areas because, as financial markets deepen and corporate control becomes tighter, it tends to put pressure on enterprises to increase their profitability, which is sometimes impaired by costly regulation in product and labour markets. Hence, financial liberalisation should increase pressures to reform such regulation. In practice, however, empirical linkages between financial market liberalisation and other reforms have been documented for only a few sectors.[18]

The empirical evidence is much stronger concerning the effect of the external product market environment on domestic policies. Such external factors comprise labour and product market policies in other countries, tariff barriers, participation in international organisations, etc. For instance, OECD estimates suggest that these factors can explain a significant part of observed liberalisations in OECD telecommunications markets over the past two decades. There are different mechanisms at work. Liberalisation abroad may in itself serve as a source of inspiration. Moreover, together with domestic trade liberalisation it may increase competitive pressures on domestic enterprises and thereby strengthen pro-reform constituencies. EU membership and the Single Market Programme have also been strongly associated with reforms in domestic markets, and NAFTA has been found to exert a liberalising influence on trade policies. This suggests that, historically, an important avenue to generate impetus for structural reform has been an internationally cooperative approach to liberalisation.[19]

A fairly robust empirical finding across a number of studies is that liberalisation in product markets is often followed by liberalisation in labour markets. OECD estimates suggest that roughly one-fifth of the spread between most and least regulated labour markets in OECD countries could be related to differences in the stringency of product market regulations. There are a number of reasons why that may be so. One is that enhanced product market competition reduces the ability of firms to earn excess profits by squeezing their price-cost margins. This in turn undermines labour market institutions that make it easier for workers to share these excess profits with firms. Another is that product market reform may boost demand, employment opportunities and real wages, making it easier to undertake labour-market reform. For instance, product market reforms may improve the conditions for achieving an easing of employment protection rules, as such reforms are found to increase employment opportunities (Bassanini and Duval, 2006; Nicoletti and Scarpetta, 2005), thereby reducing the incentives for incumbent workers to protect their jobs through strict rules.

Regarding labour markets, different approaches to reform seem to be required depending on national circumstances.[20] No general empirical relationships in this area have been identified across countries. Some OECD countries that have gone far in reforming labour markets (*e.g.* United Kingdom, New Zealand) introduced deep changes in the system of industrial relations, undermining the influence of incumbent workers through, for instance, changes in union rights and procedures for industrial action. Others (*e.g.* Denmark, Ireland, and the Netherlands) have been able to achieve reform in more corporatist set-ups, where organisations are representative of wide constituencies.[21] Others still (*e.g.* Spain) at first bypassed incumbents by introducing reforms that mainly affected workers with a weak labour market attachment (*e.g.* using fixed-term contracts) and, when labour market duality subsequently became glaring, pressed for changes that would affect regular workers as well. In most countries, however, this reform strategy in the area of job protection has not been completed, thereby leading to dual labour markets, with precarious jobs for newcomers.

Reform strategies

The review of the evidence on factors affecting structural reform implementation points to some tentative lessons, positive and negative, that can be learnt from the past experience with economic reform highlighted by OECD surveillance processes.[22]

First of all, the fact that opposition to reform is often grounded on complexities related to the costs and benefits of policy changes and the trade-offs between economic and other objectives suggests that comprehensive and transparent explanations are essential elements of successful structural reforms. The various stakeholders should have a clear understanding of the problems and of the solutions – including the involved costs and benefits – in both the short and the long run. To this end, use of outside expertise may bolster the case for structural reform.[23]

Secondly, the role of supportive macroeconomic policies should be recognised. Macroeconomic policies designed to keep aggregate demand close to potential output may facilitate the conduct of structural reforms by minimising the fear that structural change could be associated with deficient aggregate demand. In countries with domestic monetary anchors, it may be worth increasing awareness that if such shortfalls in demand were to result from structural reform, they will not be left to linger. In countries which participate in a monetary union, it may be considered whether there exist co-ordinated approaches to structural reform that would allow monetary accommodation consistent with price stability. Completion of the EU internal market is one case in point.

On the fiscal policy side, sound public finances are likely to create the wherewithal required for the introduction of some structural reforms, by providing confidence and room for manoeuvre. In countries where fiscal deficits are substantial, the necessary consolidation could complicate the course of reform in the short run but will ultimately help to create scope for macroeconomic accommodation or for transitional policies aimed at buffering the temporary costs of reform for stakeholders.

Thirdly, sequencing and synergies between structural policies may significantly facilitate reform. Internationally co-ordinated approaches to product market reform at or inside borders appear to have been successful historically and to be able to generate momentum for further reforms. Obvious opportunities to pursue this route would be a reanimation of the currently stalled Doha Round and a rapid and effective implementation of the internal EU market for services. Further opening of borders and more extensive liberalisation of product markets within countries may also pave the way for labour market reforms. However, it has to be recognised that much of the low-hanging fruit has been picked in product markets and that reforms in those service sectors (including utilities) that remain heavily regulated will not be easy, partly because of the related labour market dimension.

In labour markets, the limitations associated with changes that are both strong and concentrating on the margins of the market have become increasingly clear in a number of OECD countries. For instance, experience suggests that selective easing of employment protection legislation focusing on workers weakly attached to the labour force, is unlikely to lead to more comprehensive reforms. Rather, the resulting labour market duality generally spurs opposition to further marginal reforms. The need for reforms establishing a common set of rules for shaping the career profiles and the mobility of workers without constraining job turnover is therefore more obvious. Several OECD countries were able to implement reforms of this kind, such as Austria in the area of hiring and firing rules and a

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number of other OECD countries in the area of unemployment insurance. The political viability of such reforms often hinges on the possibility to "grandfather" the initial rights of stakeholders during the transition to the new labour market environment.[24]

Notes

1. The chapter is based mainly on Duval and Elmeskov (2005), Duval (2005) and, especially, Høj *et al.* (2006). All of these studies use panel regressions covering both the country and time-series dimensions to identify the link between indicators of structural policy settings and a number of political economy influences. The studies differ in coverage and methodology but, due to data constraints, all of them focus on the experience of 21 OECD countries, excluding the Czech Republic, Hungary, Iceland, Korea, Luxemburg, Mexico, Poland, the Slovak Republic and Turkey.
2. Conway and Nicoletti (2006) provide a more detailed description of trends in sectoral product market reforms in OECD countries.
3. For instance, telecommunications reform is arguably related to technological advances that occurred over the past two decades and a similar case can be made for the role played by more recent technological developments in electricity generation (see, for instance, the discussion in OECD, 2001).
4. The "collective action" problems generated by the asymmetry between the losers and beneficiaries of public policies have been stressed by Olson (1965); distributional and timing effects of reform by Coe and Snower (1997); and the role of uncertainty about reform outcomes by Fernandez and Rodrik (1991).
5. In some cases, notably for labour market reforms easing employment protection legislation for regular contracts, the *perception* of costs and benefits dictates attitudes towards reform, with a large number of regular workers tending to overestimate the probability of losing their job and the smaller pool of unemployed tending to ignore the possibility of increased job opportunities under the new proposed rules.
6. The influence of private interests on the design of public policies has been stressed earlier on by Stigler (1971) and Peltzman (1976).
7. See, for instance, IMF (2004), Pitlick and Wirth (2003), Duval and Elmeskov (2005) and Høj *et al.* (2006).
8. Nevertheless, reforms in certain specific labour market areas (*e.g.* job protection and income support systems) seem to be more easily implemented during upswings (Høj *et al.* 2006).
9. See Høj *et al.* (2006). Presidential political systems and majoritarian electoral rules are sometimes held to favour structural reform. In practice, however, the empirical evidence for structural reform is more fragile than for macroeconomic policy reforms such as fiscal stabilisation.
10. To the extent that older workers' and retirees' incomes are particularly affected by the rate of return on their savings, it is understandable that they should favour reforms making product markets more efficient and competitive (Høj *et al.* 2006). At the same time, they are likely to oppose reforms affecting pension systems (see, for instance, Galasso, 2006).
11. Reforms, notably in financial markets, could in some cases boost demand more than supply in the near term in which case the issue would relate to a need to restrain aggregate demand. As well, in countries with efficient financial markets, even labour market reforms could boost aggregate demand in the short run as expected gains in output are being capitalised in asset prices and thus stimulate consumption. Unfortunately, many of the countries most in need of labour market reform also appear to be ones where financial markets are unlikely to play such a role.
12. A number of further arguments as to why the orientation of monetary policy may affect structural reform are discussed in Nicoletti *et al.* (2001) and, especially, Duval and Elmeskov (2005).
13. This may be particularly true of participation in "hard" currency regimes, such as a monetary union, under which reneging on existing exchange rate arrangements is typically more costly than under "looser" regimes – such as an exchange rate target.
14. Nicoletti *et al.* (2001) and, in particular, Høj *et al.* (2006) find little evidence of monetary autonomy playing a role at either the level of aggregate product and labour market reforms or at the level of individual policies. Duval and Elmeskov (2005), by contrast, find that the likelihood of major structural reforms in labour and product markets could be increased by between 5 and 20 percentage points (the latter applying to larger, more closed economies).

15. To some extent, structural reform may itself create the resources for fiscal adjustment later on. For example, reforms that boost the sustainable employment level also tend to durably improve government budgets, giving scope for tax cuts if the initial fiscal position allows. Empirical evidence of this phenomenon is provided by van den Noord and Cournède (2006).
16. Van den Noord and Cournède (2006) find that, on average, in those OECD countries where structural reform has been implemented, the estimated budgetary savings brought about by improvements in structural policy settings dominate their short-term costs.
17. OECD member countries have progressively engaged in opening up international capital movements ever since the signature, in 1961, of the OECD Code of Liberalisation of Capital Movements.
18. For instance, significant links were found between financial market deregulation and the liberalisation of telecommunications (Li *et al.* 2001) and air travel (Høj *et al.* 2006).
19. This said, tariff cuts appear historically to have been associated with higher tax wedges and more generosity in unemployment benefit systems which, if not embedded in a system of mutual obligations, could impair labour market performance. These developments may have been part of the political package to allow liberalisation (Høj *et al.* 2006).
20. See Chapter 4 in this volume and Chapter 6 in OECD (2006b).
21. The role played by the quality of industrial relations for explaining differential unemployment developments across European countries over the past three decades is stressed by Blanchard and Philippon (2004).
22. Several OECD bodies are involved in the multilateral peer review of structural reform in its country-specific (*e.g.* economic surveys and regulatory reform surveys), cross-country (*e.g.* employment, competition and taxation policies) and international (*e.g.* liberalisation of capital movements) dimensions.
23. Several OECD countries have established bodies whose primary task is to advise the government and inform the public on topics related to structural reform, a prominent example being the Australian Productivity Commission.
24. In Austria, new rules for work contracts include compensation in case of lay-off through a system of individual saving accounts that does not distort hiring and firing decisions of firms. Partly inspired by the Nordic "flexicurity" system, a number of countries have reformed unemployment insurance based on "activation/mutual obligations" approaches which seek to balance job-seekers taking more active steps to find work and/or improve their employability with more effective active labour market policies, backed by the threat of benefit sanctions.

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