2 *Going for Growth 2019* – reform actions taken in 2017-18

The pace of reforms is not fast enough. After a peak of reform action in both advanced and emerging-market economies following the global financial crisis, the pace of structural reforms has moderated again, implying a lost opportunity to boost growth. This chapter assesses the overall progress in structural reforms that OECD and key non-OECD member countries achieved on the past Going for Growth priority areas over 2017-2018. The detailed country-specific information supporting this chapter is available in country notes (Chapter 4).

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

In Brief

The pace of reforms is not fast enough

Over 2017-18 the overall pace of structural policy reforms has remained similar to the pace observed in the last five years and to the one before the financial crisis. This reform pace is below the peak in the direct aftermath of the crisis.

Still, despite this overall moderate pace of reform some countries have recently implemented major reforms.

For example, Japan took actions to support the labour force participation of all segments of the population, and in particular that of women, notably by improving its childcare capacity. In addition, both Japan and Korea passed new legislation aimed at limiting overtime work and improving work-life balance. France passed comprehensive labour market reforms to improve collective wage bargaining, ease labour market transitions, reduce the tax wedge for low-income workers and strengthen lifelong learning. It also extended unemployment benefits to self-employed in combination with reinforced job search controls.

Denmark passed a major reform of housing taxation in 2017, reinforcing the progressivity of its housing taxation. India rolled out a nation-wide goods and service tax, while Argentina reduced corporate income taxes and increased taxes on undistributed profits to encourage investment. Spain and Poland took significant measures to improve the collection of VAT and the United States reduced its corporate income tax rate.

Greece and Italy rolled out nation-wide anti-poverty schemes ensuring that households have access to a minimum income. China made progress on bridging the rural/urban divide in its health system, notably by facilitating the portability of health insurance, while India launched a national healthcare scheme to cover 100 million poor families.

The pace of structural reform action has also differed across policy areas. Advanced economies have focused on addressing increasing labour shortages by lifting impediments to the labour force participation of women, strengthening social policies and redesigning tax systems. Emerging-market economies have increasingly aimed at encouraging formal jobs by reforming labour market regulations, boosting skills and reducing the high taxation of labour.

Introduction

Going for Growth builds on OECD expertise on structural policy reforms and economic performance to provide policymakers with concrete reform recommendations to boost growth in an inclusive and sustainable way (Chapter 1). Tracking the progress on structural reforms is an essential part of the *Going for Growth* exercise. Reform actions are hence reported for each two-year period, in light of the respective national priorities that were identified in the previous edition of *Going for Growth*. This edition of *Going for Growth*, and in particular this Chapter, focuses on reforms taken in 2017 and 2018.

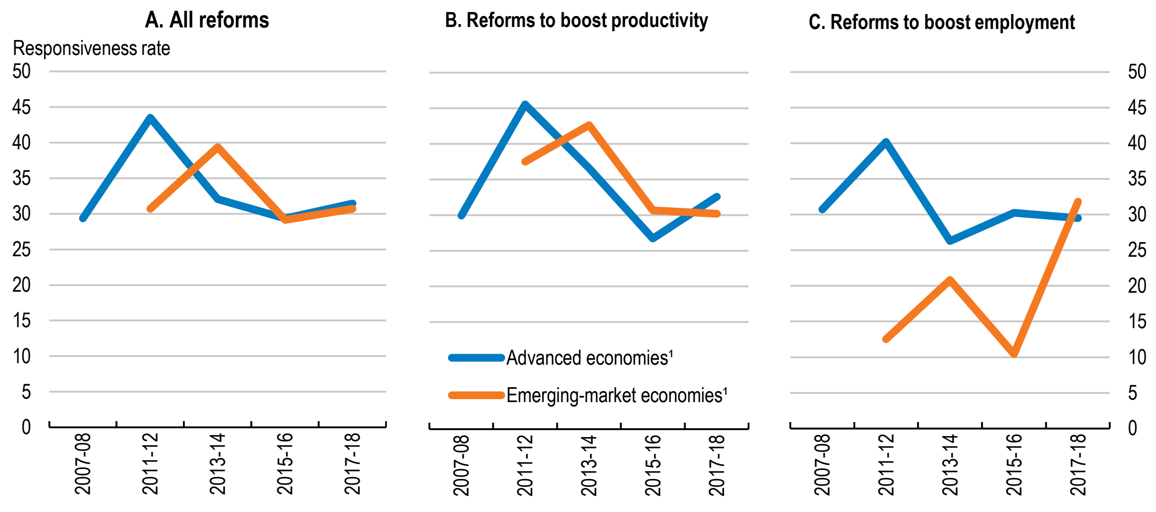
In 2017 *Going for Growth* reported a moderation of structural reform efforts following a post-crisis peak (OECD, 2017a). The pace of reforms stabilised at levels similar to those observed before the crisis, both in advanced and emerging-market economies. This moderate pace has continued in 2017-18, albeit with significant reform actions taken in some countries.

Patterns of reform activity by policy areas

On average, reform activity in advanced and emerging market economies, as measured by the reform responsiveness indicator (RRI, Box 2.1), has remained similar to the pace observed the last five years and to the one before the financial crisis (Figure 2.1). This reform pace is below the relatively high pace observed in the direct aftermath of the crisis. This overall pattern hides heterogeneity in the actions taken across the main policy areas (Figure 2.2), as well as in the difference in the significance of individual reforms.

Figure 2.1. Reform activity has stabilised at the pace observed before the crisis

Responsiveness to *Going for Growth* recommendations across countries



1. In this publication, the group of advanced economies comprises all OECD member countries excluding Chile, Mexico and Turkey. These three countries, alongside Argentina, Brazil, China, Colombia, Costa Rica, Indonesia, India, Russia and South Africa are labelled emerging-market economies.

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Box 2.1. The reform responsiveness indicator – a quantitative indicator of reform action

A "responsiveness rate" indicator (RRI) is constructed for each *Going for Growth* priority area and country to summarise and assess the progress made by countries in addressing reform priorities. The RRI measures the share of total policy recommendations, within and across priorities, on which governments in each country have taken reform action.

The RRI is based on a scoring system in which recommendations set in the previous edition of *Going for Growth* take a value of one if reform action is taken and zero if not. An action is considered, if it addresses the *Going for Growth* policy recommendation and is legislated or implemented. Announcements and government plans are not taken into consideration.

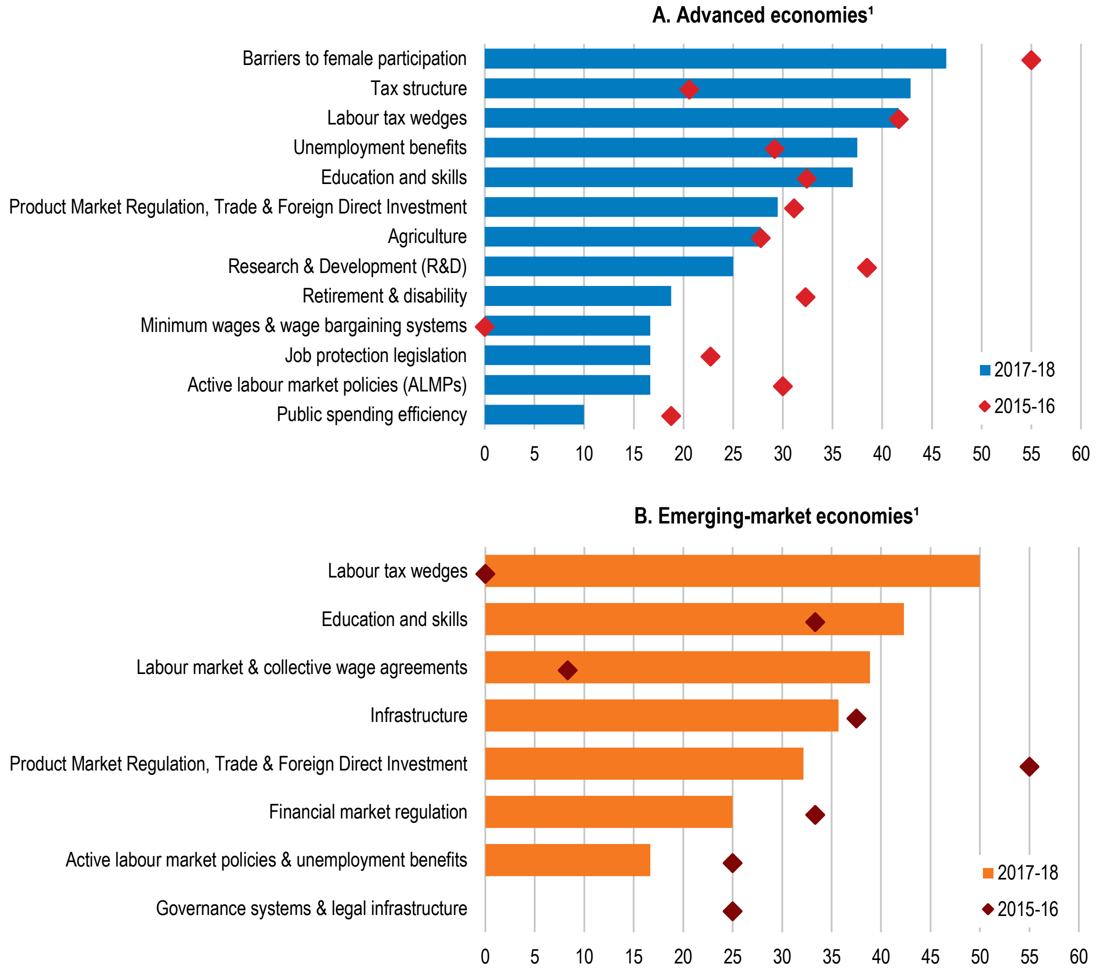
The denominator is the sum of policy recommendations. A single *Going for Growth* priority usually entails more than one recommendation. For example, product and service market reform priorities can cover both economy-wide barriers (e.g. lengthy and bureaucratic procedures for start-ups, excessive and non-transparent licensing requirements, general barriers to trade and investment) as well as industry-specific barriers (e.g. weak competition in retail trade, barriers to market entry in electricity or telecoms).

The 2017-2018 RRI focuses on actions taken in the course of 2017 and 2018 in response to *Going for Growth 2017* recommendations. Aggregates across countries, groups of countries and reform areas are also created.

The RRI is a simple measure giving a general picture, comparable across countries and time, but with some limitations. Firstly, it focuses on policy reforms in the Top 5 areas identified in *Going for Growth* as most crucial for boosting inclusive growth, not on all policy actions. Secondly, it does not attempt to assess or discriminate by the significance of measures in terms of the sufficiency to address the underlying challenge, the effectiveness of the implementation or the political economy context. For more details see Box 2.2 and Annex 2.A1 in the 2010 edition of *Going for Growth* (OECD, 2010a).

Figure 2.2. Reform intensity has remained moderate, but notable action is visible in some areas

Responsiveness to *Going for Growth 2017* recommendations across policy areas



1. In this publication, the group of advanced economies comprises all OECD member countries excluding Chile, Mexico and Turkey. These three countries, alongside Argentina, Brazil, China, Colombia, Costa Rica, Indonesia, India, Russia and South Africa have been labelled emerging-market economies.

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Reforms to boost labour productivity

Among reforms aiming to boost labour productivity in 2017-18, advanced economies were most active in the area of taxation, as part of a general trend to support investment and enhance the inclusiveness of the tax systems (OECD, 2018a). For example:

- Australia lowered corporate income taxes for SMEs in 2017 and adopted a path of short- and medium-term reductions in personal income taxes targeted to low- and middle-income earners.
- The United States cut its corporate income tax rate in late 2017, as part of a major tax reform (Box 2.2).
- Japan has continued cutting the corporate income tax rate, though the planned hike in the consumption tax rate for 2017 has been delayed until 2019.

- Denmark passed a major reform of housing taxation in 2017, introducing a new system for housing valuation and replacing the nominal freeze of property taxes with proportional taxation, maintaining the progressivity of the system (Box 2.3).
- Several countries also took measures to broaden their tax bases, e.g. in the federal budget Canada removed a number of inefficient tax expenditures such as restricting income splitting between household members within the small business tax regime.
- Several countries took measures to improve VAT compliance. For example, Spain introduced an electronic filing system to address fraud. Poland created a centralised data warehouse, merged tax administration, customs and fiscal control operations to improve co-ordination, introduced improved modelling tools to better detect irregularities and facilitated information exchange with banks when there is a suspicion of tax fraud. The Slovak Republic also took measures to fight tax evasion and increase its VAT collection, in particular through improved taxpayers' risk assessment and mandatory e-communication for taxpayers.

Box 2.2. Selected tax reform examples – corporate taxation in the United States

A major tax reform was signed into the law at the end of December 2017. The main thrust of the reform aims at reducing marginal statutory tax rates for personal and corporate income and simplification of the tax system. Changes to the taxation of business income include a cut in the federal government's statutory corporate income tax rate from 35% to 21% and an increased bonus depreciation rate (to 100% for 2018 to 2022, to be phased out by 2026). Personal income tax deductions were introduced for individuals receiving income from pass-through businesses (businesses that allocate all income to owners who are taxed, to avoid double taxation) (to expire by 2025). Business interest deductions are disallowed for interest in excess of 30% of measures of business income. A carryback treatment of the net operating loss deduction was repealed. Finally, a one-off tax on un-repatriated foreign earnings will be levied at either 8% or 15.5%, depending on whether the earnings are illiquid or liquid. The reform also represented a shift towards a semi-territorial tax system, including significant measures to discourage moving intellectual property to book profits in low-tax jurisdictions.

Personal income tax rates were reduced for most brackets starting from 2018 (to expire in 2025), while the indexation of tax brackets were changed to better reflect inflation. The standard deduction was increased and the Child Tax Credit is expanded. The reform capped State and Local tax deductions to USD 10 000 and deductions for education and medical expenses were reduced. The threshold for the estate tax was doubled to USD 22 million while mortgage interest deduction was capped at interest on USD 750 000 worth of loans (down from USD 1 million).

Box 2.3. Selected tax reform examples – taxation of housing in Denmark

Denmark introduced important changes to housing taxation. From 2021, housing taxes – including both the property value tax and the land tax – will reflect property market values, thereby ending the property valuation freeze in place since 2002, which has led to falling effective tax rates for homes increasing in value. For many homes, this change will lead to higher valuations. Tax rates will be lowered, however, and homeowners whose overall housing taxes increase with the new system will be compensated through a tax rebate. In an effort to protect homeowners from tax increases while they occupy their home, the payment of tax increases after 2021 will also be deferred until the home is sold.

In emerging-market economies, the most active areas of reform to boost labour productivity have been in the provision of infrastructure and education. For example:

- In India, a massive electrification programme has resulted in providing electricity to all villages in 2018.
- Argentina increased infrastructure investment with several projects developed as public-private partnerships. Likewise, in Indonesia transport infrastructure investment increased and reforms removed obstacles related to land acquisition.
- Chile continued to expand its childcare centres, with more than 70 000 new places created in 2017 and by setting up new institutions in charge of monitoring, updating curricula and setting quality standards.
- Colombia launched a programme aiming at raising the quality and accessibility of higher education, in particular using subsidised loans for disadvantaged students.

Reforms to boost labour utilisation

Among priorities to enhance employment in 2017-18, several advanced economies aimed at addressing labour market shortages through reforms to lift barriers to female labour market participation, redesigning unemployment benefits and retirement schemes. This extends the trend in reform action already observed in the last edition of *Going for Growth*. For example:

- In the Czech Republic, Germany and Japan childcare provision was scaled up. For instance in Czech Republic, from 2018 children older than 3 years are guaranteed places in childcare and in Japan free early childhood education and care for children aged 3 to 5 will be provided from October 2019. Both Japan and Korea passed new legislation aimed at limiting overtime work and improving work-life balance.
- Hungary abolished in 2018 social security contributions for old-age pensioners who remain in the labour market.
- Estonia lowered the tax wedge for low-wage earners in 2017 by increasing the threshold of the tax allowance in personal income taxation.
- In 2018, Israel increased the earned income tax credit for men to the level of women.
- Regarding older workers' labour force participation, Austria slightly raised the fiscal incentives for firms to employ older workers, through successive cuts in payroll taxes.
- Korea increased minimum pensions while expanding training programmes aimed at older workers in combination with subsidies for those who participate.
- France lowered employer social security contributions for low-income workers and increased in-work benefits.

In emerging market economies, reform activity was the highest in the area of labour market regulations and labour taxation. Poorly designed and excessive labour market regulations and high labour taxes can be strong drivers of informality and unemployment, hampering growth and social inclusion.

- In 2018, Costa Rica launched a national strategy to reduce informal employment from an estimated 43% to 33% by 2025. This included measures to encourage whistleblowing, cuts in social security contributions and a slight reduction of the numerous minimum wage categories.
- South Africa progressed on reforming the wage bargaining system, with the implementation of the national minimum wage in 2019.
- Turkey reduced employers' social security contributions on wages, and for firms that have increased their net employment over 2016 new hires will be exempt from social security contributions for one year.

Selected examples of significant reforms

The overall modest pace of reform reported in this *Going for Growth* edition masks that some countries took significant actions in specific priority areas. For example:

- India replaced multiple indirect taxes levied by the states and central government by the Goods and Services Tax in 2017 (Box 2.4).
- In France, a major reform was taken to increase the role of firm-level agreements in wage setting, improve legal certainty for dismissals and streamline worker representation in 2017 (Box 2.4).
- Japan took steps to expand childcare capacity and providing free early childhood education. The legal framework was strengthened to tackle market dualism and discrimination against non-regular workers (Box 2.4).
- Greece rolled out nation-wide its “social solidarity income” to provide a safety net against poverty, while reforming the administrative infrastructure for identifying eligible households and transferring funds by electronic means (Box 2.4).
- Along the same line, Italy implemented a conditional guaranteed minimum income targeted at households in poverty.
- In the area of health, China has improved access to health by increasing the portability of health insurance.
- India launched a national health protection scheme targeting 100 million poor families for secondary and tertiary care.

Box 2.4. Selected significant reform examples

The Goods and Services Tax in India

The Goods and Services Tax (GST), in effect as of 2017, replaced various taxes on goods and services levied by the central government and states by a single tax on value added. The GST reform harmonises indirect tax rates on goods and services that previously differed across states and entailed "tax cascading" (not all indirect taxes on inputs paid by enterprises could be deducted from indirect taxes on outputs so that taxes-on-taxes were due). Under the GST, goods and services are subject to four categories of tax rates: 5% (mostly food items plus rail and road passenger transport); 12% (air transport, hotels and restaurants); 18% (the default rate, applying to many food items, chemicals, manufacturing materials, leather and paper products, footwear and many manufactured products); and 28% for some luxury, sin and demerit goods (including sodas, chocolate, coffee, luxury hotels, tobacco and luxury cars). Several items are exempt, including alcohol, tobacco and petroleum products. Firms with a turnover of less than INR 4 million are exempt from GST. The GST Council governs tax rates, rules and regulations concerning GST. The Council consists of the Finance Minister of the central government and the Finance Ministers of all the states.

Labour market reforms in France

The 2017 labour market reforms aimed at facilitating collective bargaining and firm-level negotiations. They also seek to reduce legal uncertainty surrounding dismissals for open-ended contracts, notably through a binding scale for compensation for unfair dismissals. Company-level agreements now have the precedence over sector-level agreements on bonuses and working hours. Moreover, it will no longer be possible to extend a sector-level agreement if it does not include specific stipulations for smaller firms and an independent committee may evaluate the economic and social effects of administrative extensions of sector-level agreements before their extensions. In addition, new unemployment insurance rights have been made open to some self-employed workers and resigning employees.

To complement these measures, the French authorities reduced labour costs for low-wage workers and strengthened employment incentives through higher in-work benefits. They also reformed the lifelong learning and apprenticeship systems. Regular evaluation of vocational training programmes is planned, aiming to improve their quality.

Social protection reforms in Greece

The Social Solidarity Income (SSI) has been rolled out nationally in February 2017, while strengthened family benefits were introduced in 2018. These measures aim at better supporting the poorest households by ensuring that they can access a minimum income, even if they are not supported by other social protection programmes. The SSI transfers target low-income households and are set at EUR 200 per month for the first household member, EUR 100 for the second and EUR 50 for children. In addition, two programmes complement the SSI, seeking to improve households' access to labour market programmes and to other social support services.

Reforms to raise labour market participation and employment in Japan

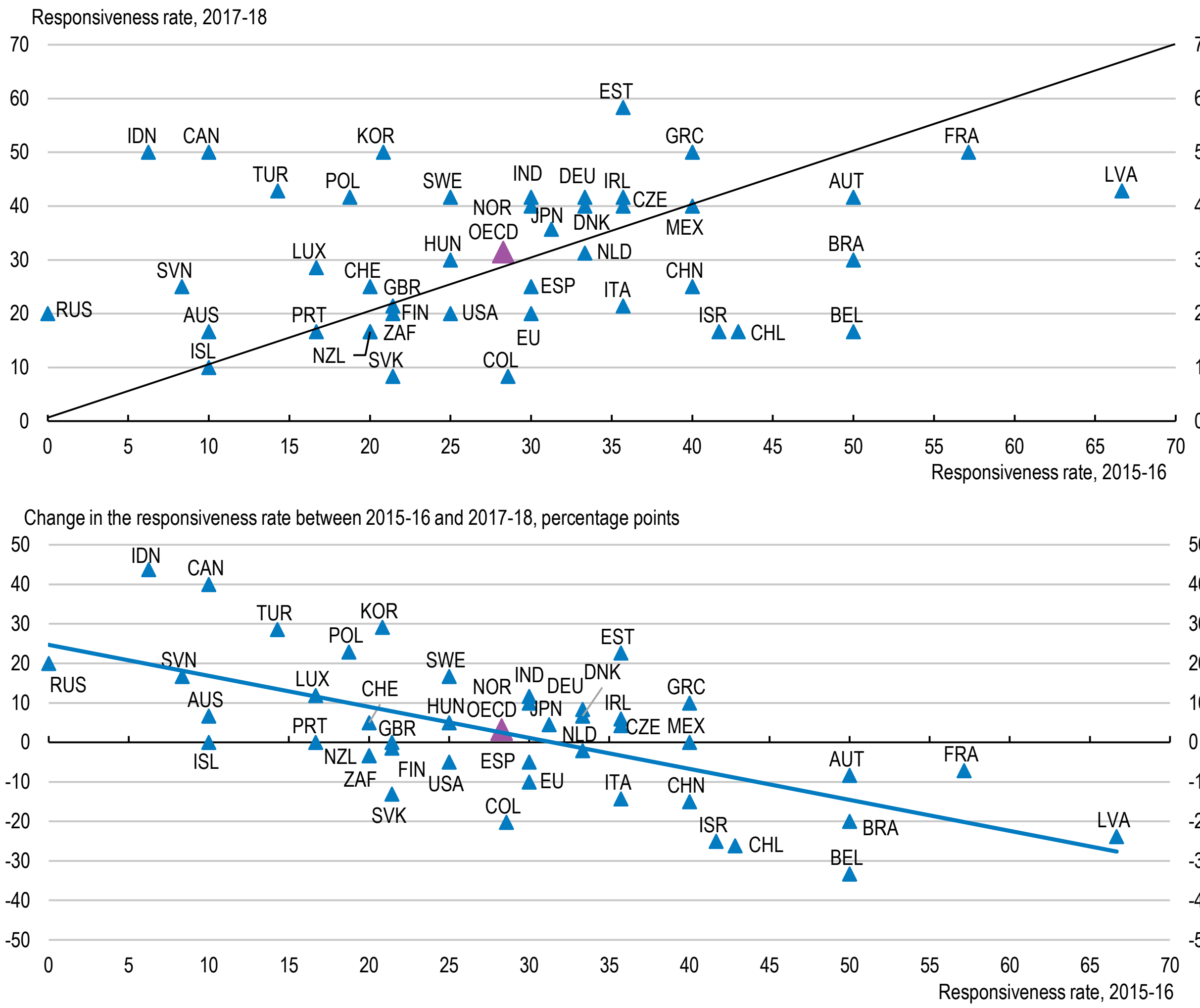
To promote the engagement of all available talents in the labour market, a plan to expand childcare capacity by 320 000 children by 2020 was launched in 2018. This will be accompanied by the introduction of free early childhood education and care in October 2019 for children aged three to five. In addition, a plan will be formulated in 2019 to encourage employment opportunities until the age of 70. Measures to fight entrenched labour market duality were implemented in 2018, including strengthening firms' accountability for discriminatory treatment of non-regular employees and the launching guidelines for balanced treatment between regular and non-regular workers. The government has also increased support for vocational training for non-regular workers.

Patterns of reform activity across countries

Reform responsiveness to the 2017 priorities shows wide differences across countries (Figure 2.3, Panel A). Countries that tended to reform more intensively in the past are more likely to see a slowdown in reform activity thereafter (Figure 2.3, Panel B). This is possibly due to the need to approve necessary accompanying secondary legislation, the transmission of laws from central to local governments, court challenges and insufficient or ineffective administrative capacity. For example, in Spain the implementation of the Market Unity Law, which aimed at reducing barriers between provinces, is technically challenging due to the complexity of dealing with a large body of regulation. It also requires greater co-operation between the central government and the regions (OECD, 2017b), and improving the quality of laws and regulations (OECD, 2018b).

Figure 2.3. Reform intensity is lower in countries that were more active in previous periods

Responsiveness to *Going for Growth* recommendations



Note: In panel A, the line is a 45-degree line. In Panel B, the line is a simple linear regression line.

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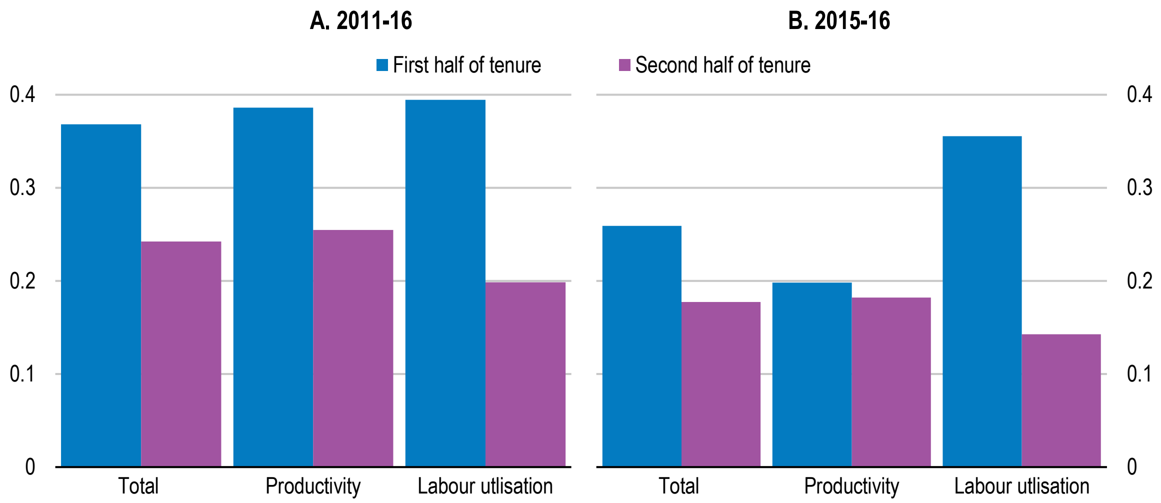
One often cited reason for the slow pace of reform is reform fatigue, following the peak of reform activity in the direct aftermath of the global crisis (OECD, 2015). Governments may be unwilling to face the short run costs of structural reforms. Some reforms may hit the most vulnerable in the short run, even if the overall effect is positive in the medium-term (Bouis et al., 2012). Examples include wage bargaining reforms aimed at encouraging wage responsiveness to cyclical and local conditions as well as tax reforms to achieve internal devaluation in the absence of exchange rate adjustment (i.e. fiscally-neutral reductions in employers' labour costs financed by increased consumer taxes). However, the Business and Industry Advisory Committee to the OECD (BIAC) annual members' survey indicates year after year business' support for structural reform action in the *Going for Growth* priority areas (BIAC, 2018).

The lack of trust in government can also make reform implementation difficult. Trust in government has deteriorated strongly in many OECD countries (OECD, 2017c). Trust is affected by many factors, including economic and financial uncertainty, misuses of public resources and the perception that growth has not been sufficiently inclusive. Businesses view the lack of political will and a lack of political or policy consistency as a key obstacle to reforms in their countries (BIAC, 2018). Increasing the efficiency of the public administration and upholding the rule of law are fundamental for winning back trust in governments, as reflected in *Going for Growth* recommendations (Chapter 1).

An additional reason for differences across countries in reform responsiveness may be linked to the political economy of reforms. Reforms are more likely to be successfully implemented in the presence of clear political mandate and an effective communication strategy. More cohesive governments, united around the reform proposal and with a stronger parliamentary majority also more likely to make reform happen (OECD, 2010b). There is some evidence that newly elected governments are more likely to implement reforms as the next election is some time away (Alesina, 1993). For example, across OECD countries, incoming governments tend to be more active in reform, gradually losing steam as their mandate ages (Figure 2.4).

Figure 2.4. New governments tend to reform more

Reform responsiveness indicator by government tenure



Source: World Bank, Database of Political Institutions Codebook, 2017 Update.

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Cross-country differences in reform activity can be also explained by the stalling, watering down or backtracking of reforms. For example:

- Some planned reforms, such as the liberalisation of professional services in Spain, have been postponed with unclear prospects for its eventual implementation (OECD, 2017b).
- In Austria, the trade law reform turned out to be less ambitious than expected and the extension of full-day childcare has stalled somewhat.
- In Japan, the hiking of the consumption tax rate to 10% – planned already in 2015 – has been further delayed and will be accompanied by the introduction of multiple rates.
- A number of countries have introduced actions that go in the opposite direction of past *Going for Growth* recommendations. Examples include the lowering of the pension age in Poland, the growth of fossil fuel subsidies in Indonesia and increasing variable subsidies for rice in Korea. Moreover, in Korea the minimum wage hike was higher than recommended.

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