



OECD ECONOMIC POLICY REFORMS GOING FOR GROWTH 2018

- EDITORIAL
- EXECUTIVE SUMMARY
- UNITED STATES NOTE

*G20 FINANCE MINISTERS & CENTRAL BANK
GOVERNORS MEETING*

19 MARCH 2018

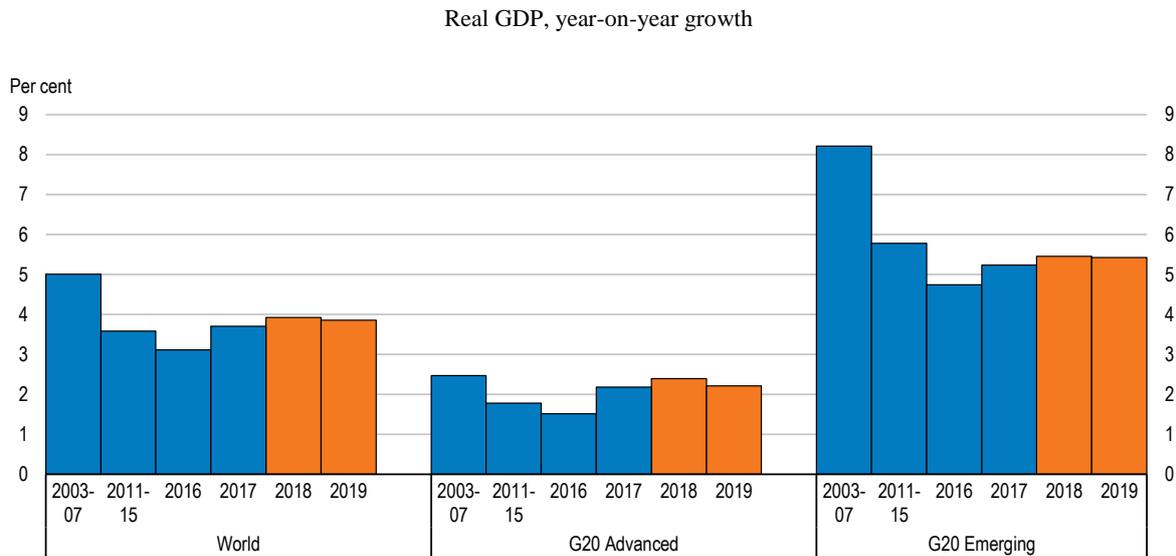
BUENOS AIRES, ARGENTINA



Editorial:
An opportunity that governments should not miss

Global growth is finally back to cruising speed. For the first time in many years, all the major regions of the world are enjoying a widespread and largely synchronised upswing, even if some economies have been in steady expansion for much longer than others. Hopefully, the stagnation of living standards endured by a large share of the population in many OECD economies is coming to an end. The more rapid decline in unemployment seen in recent months is clearly an encouraging sign. However, the improvements in labour markets have yet to translate into significant and broad-based wage gains. Comprehensive structural reforms are needed to sustain stronger growth beyond the cyclical upswing, create more and better paying jobs, improve opportunities and strengthen inclusion.

Figure 1. Global growth is back to cruising speed

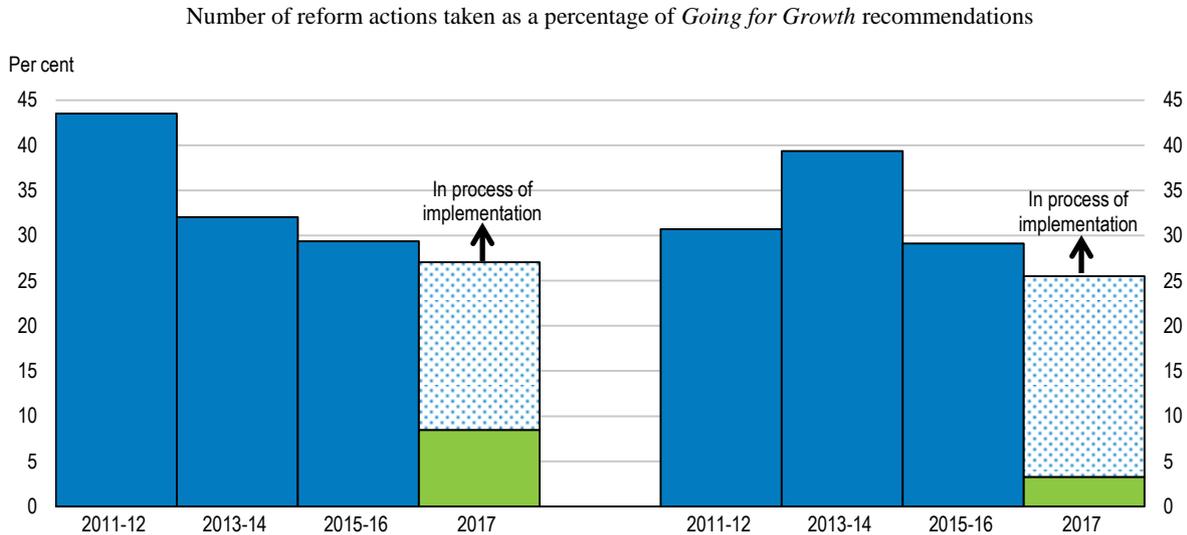


Note: Average of annual growth rates for 2003-07 and 2011-15. OECD Projections for 2018 and 2019.
Source: OECD, *Interim Economic Outlook*, March 2018.

Based on the review of actions taken on structural policy priorities presented in this *Going for Growth* report, there is little sign of an imminent pick-up in the pace of reforms. If anything, the review points to a further slowdown in 2017 from the already modest pace observed in the previous two years. Notwithstanding, some countries have managed to introduce significant reforms in the past year. In Japan, measures have been taken to improve access to childcare services, helping women to stay in the labour force. France has implemented a broad labour market reform, covering both employment

protection legislation and collective wage bargaining. India has rolled out a goods and services tax, while Argentina has just passed a comprehensive tax reform.

Figure 2. The pace of reforms is modest



Note: Fully coloured bars refer to the share of fully implemented reforms. For 2017, reforms in the process of implementation are included to ensure comparability with previous two-year periods. For the two-year periods, the responsiveness rate is annualized. Emerging economies include Chile, Mexico, Turkey, Argentina, Brazil, China, Colombia, Costa Rica, Indonesia, India, Russia and South Africa. Advanced economies include all non-emerging OECD member countries and Lithuania.

By and large, governments have continued to devote greater attention to employment and social protection, including also through measures to improve healthcare services. Examples include Greece and Italy, where significant measures have been taken to strengthen social protection, as well as China, where access to healthcare for migrant workers has been improved. The broader attention to employment and income support is important for achieving greater inclusiveness and a more balanced distribution of income. To a large extent, reform efforts are paying off: the employment rates of low-skilled and youth – still low in some countries hardest hit by the crisis – are improving and already roughly back to their pre-crisis levels on average across countries, while the labour-force participation of women continues to rise.

However, significant reforms have remained too few and far between to boost productivity and to reduce the reliance on macro-policy stimulus. The return of higher global growth offers a window of opportunity to make renewed progress on structural reforms, with higher chances that they bear fruit more rapidly. Individually and collectively, decision makers need to find ways to overcome political resistance to reforms that address well-known growth bottlenecks, and lay the groundwork for their economies to make the most of the ongoing digital transformation. Higher and more sustained growth would also help to reduce financial risks related to the high public and private debt levels built up in a low interest rate environment.

While finally gathering momentum, business investment still remains weak in comparison with past expansions. Furthermore, recent data shows that investment in digital technologies, which is fundamental to boosting productivity, varies greatly across countries and firms. The growing productivity gap between leading and lagging firms is

itself a source of growing wage inequality and productivity slowdown. OECD analysis suggests that firms face various constraints affecting both their incentives and capabilities to invest in such technologies.

Raising investment incentives requires measures to create a more competitive business environment, notably by promoting the entry of firms through lower regulatory barriers to start-ups and by reducing obstacles to foreign direct investment. Despite progress in these areas – for example in the European Union with the recent Services Package -- entry in business services in countries such as France, Germany and Spain is still hampered by administrative and regulatory barriers. Meanwhile, more needs to be done to reduce barriers to foreign investment where they remain relatively high, including Indonesia, Mexico and Russia. And, trade protectionism can only harm investment by raising costs and uncertainty, eroding the competitive environment and narrowing the scope for successful firms to grow.

There is also scope in many countries for reforming insolvency regimes to facilitate the orderly exit or restructuring of unsuccessful firms. This is important both to encourage experimentation of new ideas and to free the resources needed for successful innovative firms to expand. Chapter 3 of this Report presents new OECD indicators of insolvency regimes across countries, laying out the main design features to achieve such objectives. In countries such as Australia, Italy and South Africa, lowering barriers to corporate restructuring in case of distress is a priority. Reforms are also needed to harmonise insolvency procedures across member states in the European Union.

Taxation is another area where governments can act to raise private incentives to invest. This includes reforms of tax systems to broaden the tax base through the elimination of loopholes, not least those that mostly benefit individuals with high levels of income or wealth, while making room for rate reductions, especially on more mobile sources such as capital and labour income. Reforms along those lines have been implemented in countries such as Argentina, Canada and Spain, while corporate tax rates have been reduced in the United States. But reforms have yet to tackle a key distortion of tax systems, which is to favour debt over equity financing. Not only does such a bias contribute to making growth overly dependent on debt, but it also discriminates against innovative young firms.

More broadly, most countries have ample scope for reforms that can reconcile growth and inclusiveness objectives, notably by relying more on tax revenues from immovable property and inheritance. Internationally, in the effort to make corporate taxation fairer and more transparent, progress is being made to limit tax avoidance by multinationals through the so-called Base Erosion and Profit Shifting (BEPS) action plan elaborated under the auspices of the G20 and the OECD and the rolling out of the automatic exchange of information.

In countries such as India, Indonesia and Turkey, but also Italy and Greece, labour informality remains a key challenge for boosting inclusive growth. Addressing this requires reforms of burdensome product and labour regulations, along with reducing labour tax wedges on low-paid workers where they remain high. Bringing more workers in formal jobs will offer better prospects to improve skills and productivity while providing them with better social protection. In China, further measures to provide more equal access to public services while abolishing the household registration system, would promote labour mobility, productivity and inclusion. The effectiveness of reforms in these areas is best supported by the successful implementation of measures to reinforce the fight against corruption - such as the steps taken in Mexico - and to strengthen the rule of law.

In both emerging and advanced economies, the shortage of skills, including managerial and organisational talent, is one factor limiting the capabilities of many firms to adopt digital technologies. A longer-term response is reforms of education and training systems to ensure that workers acquire the cognitive and non-cognitive skills that the new digital technologies and knowledge-based capital make increasingly necessary. This includes measures to facilitate access to education for disadvantaged groups so as to reduce the digital divide. In the shorter term, the response to the skills shortage consists in providing workers with better opportunities for up-skilling and reducing the mismatch between the skills provided by workers and those demanded by employers. Developing training and life-long learning programmes that benefit those who need them most remains a challenge shared by most countries.

Hence, in spite of stronger economic growth this is no time for complacency. *Going for Growth* provides policy priorities and recommendations to unlock skills development and innovation capacity, to promote business dynamism and the diffusion of knowledge, and to help workers benefit from a fast-changing labour market. In the spirit of ensuring the sustainability of the gains in incomes and wellbeing it also increasingly takes into account environmental risks and bottlenecks (see Chapter 2). The current economic upswing provides a window for the successful implementation of reforms that can best achieve the objective of strong, inclusive and sustainable growth. The opportunity should not be missed.



Álvaro Pereira
OECD Acting Chief Economist

Executive Summary

At nearly 4 per cent projected for 2018, the annual GDP growth rate of the global economy is close to the pace of growth preceding the great recession. This period of strong and broadly-based global growth creates favourable conditions for the successful implementation of structural reforms – necessary to turn the upswing into stronger and sustainable long-term growth for all.

Amid these positive short-term developments, still underpinned by supportive fiscal and monetary policy, medium and longer-term challenges remain for policy makers. Productivity growth is still disappointing. Despite the long-awaited employment recovery, wages have so far failed to follow, and many vulnerable groups are still confronted with weak prospects in the labour market. Inequality is persistent and on a longer-term trend rise within many countries – indicating that parts of society have not benefited much from growth. On top of this, megatrends such as digitalisation, environmental pressures and demographics, may carry risks for the sustainability of long-term growth unless the policy challenges they raise are properly addressed.

Going for Growth provides policy makers with concrete reform recommendations in areas which are identified as the top five country-specific priorities in order to tackle medium-term challenges, revive productivity and employment growth, while ensuring a broad sharing of the benefits. The priorities are identified building on OECD expertise on structural policy reforms and inclusive growth. The areas covered are diverse, including product and labour market regulation, education and training, tax and transfer systems, as well as trade and investment rules, physical and legal infrastructure and innovation policies. Policy recommendations across these areas are articulated so as to form a coherent reform strategy, which is crucial to reap synergies, manage trade-offs and ensure that the benefits are broadly shared over time. As such, the *Going for Growth* framework has been instrumental in helping G20 countries make progress on their structural reform agenda, including through monitoring their growth strategies to achieve sustained and balanced growth.

This *Interim* report reviews progress on structural reforms with respect to priorities identified in *Going for Growth 2017*.

Actions taken on policy priorities

- In 2017, the pace of reforms has remained similar to the relatively slow pace observed in the last two years and below the one observed in the direct aftermath of the crisis.
- Nevertheless, some bold actions have been taken – over one third of actions implemented in 2017 can be viewed as “major steps”. Notable examples include reforms to strengthen social protection in Greece and Italy, a long-overdue reform of the labour market in France, significant measures in Japan to increase childcare

capacity, a goods and services tax in India and a comprehensive tax reform in Argentina, to be phased in over the next 5 years.

- More generally, the intensity of reforms has varied across policy areas. Among reforms to *boost skills acquisition and innovative capacity*, widespread actions were taken to increase the size and efficiency of R&D support.
- The bulk of actions taken to *promote business dynamism and knowledge diffusion* have focused on strengthening physical and legal infrastructure as well as on making product market regulation more competition-friendly.
- Significant actions have been taken in the area of social benefits, which is important for social cohesion. To further *help workers to cope with potentially rapid changes in jobs and tasks*, more reforms are needed in complementary areas, such as improving active labour market and housing market policies to facilitate the job-market transition and mobility.

Special chapters – reviewing indicators to enrich the *Going for Growth* analysis

This report includes two special chapters that review indicators for extending the scope of the *Going for Growth* framework: green growth indicators and OECD indicators of insolvency regimes.

The links between green and growth: what the indicators reveal

The ability to sustain long-term improvements in GDP and well-being, as advocated in *Going for Growth*, depends – among other things - on the ability to reduce negative effects (such as pollution) associated with economic activity, minimise environment-related risks and lower the reliance on (limited) natural capital resources. Hence, a more systematic approach to environment-related challenges in *Going for Growth* is warranted. At the same time, the links between the environment, environmental policies and economic growth are complex. In that regard, Chapter 2 reviews the indicators available and the recent progress made on the measurement of environmental outcomes and policies. While no single broadly-accepted measure of environmental performance exists, significant progress has been made in the measurement of green growth, notably as part of the OECD Green Growth Indicators, paving the way for a more consistent treatment of green growth in *Going for Growth*.

Facilitating orderly exit: insights from the new OECD insolvency regimes indicators

Poorly performing insolvency regimes can be linked to three inter-related sources of labour productivity weakness: the survival of so-called “zombie” firms – that should otherwise exit the market; capital miss-allocation, i.e. the trapping of resources in low productivity uses; and stalling technological diffusion. Chapter 3 presents the newly developed OECD indicators of insolvency regimes, which will allow the extension and fine-tuning of reform recommendations on exit policies in *Going for Growth*. The analysis reveals significant cross-country differences in the extent to which insolvency regimes promote orderly exit of non-viable firms, indicating that some countries have scope to improve resource allocation and productivity through reforms of bankruptcy laws and procedures.

United States

Going for Growth is the OECD flagship report analysing structural policy settings and economic performance to provide policymakers with concrete reform recommendations to boost growth and ensure that the gains are shared by all. The 2018 Interim Report reviews the main growth challenges and takes stock of reforms enacted over the past year -- in both advanced and emerging economies -- on policy priorities identified in the previous issue of *Going for Growth*.

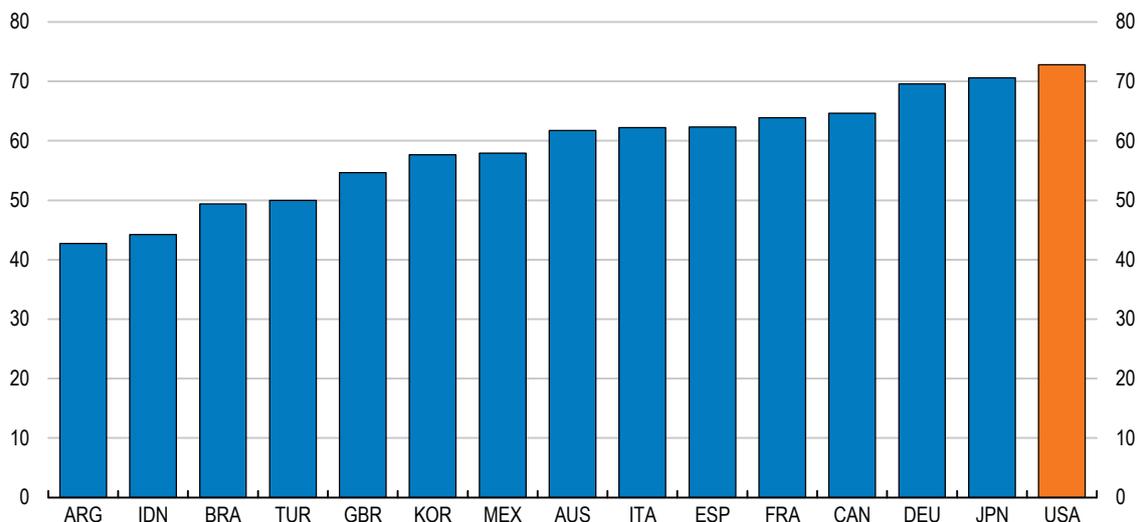
Country highlights

Per capita output remains among the OECD highest, even if it has slowed compared to the pre-crisis trend, reflecting demographic pressures on labour force participation as well as the drag on productivity growth from weak investment. Income inequality has fallen recently but remains higher than the OECD average, not least due to a low share of national income accruing to the poorest.

Public infrastructure is not keeping pace with needs of the economy contributing to congestion, urban sprawl, and environmental degradation. Actions to boost investment and maintenance of infrastructure are hence a top priority. Improving human capital formation is key as sizeable segments of the population lack opportunities to acquire and maintain skills valued highly by employers. Helping the long-term unemployed finding their way back to the labour market is also a challenge requiring a strengthening of training programmes. Finally, the US devotes a much larger share of its resources on healthcare than other OECD countries, with little apparent gain in health outcomes.

Share of direct taxes

As a percentage of total tax revenue, 2016



Note: Direct taxes aggregate taxes on income, profits and capital gains, social security contributions and taxes on payroll and workforce. Data refer to 2015 for Argentina, Australia, Brazil, Colombia, Costa Rica, Indonesia, Japan and Mexico.

Source: OECD, Revenue Statistics Database.

Going for Growth 2017 recommendations include:

- **Improve, maintain and rationalise infrastructure** by boosting investment in, and maintenance of, infrastructure. Promote mass transit, and use federal programmes to encourage co-ordination across State and local jurisdictions. Implement usage fees based upon distance travelled and congestion, to help fund transportation and to encourage users internalise the broader costs of congestion and road wear and tear. Expand federal programmes designed to improve access to fixed broadband.
- **Strengthen active labour market policies** by expanding funding for reskilling, building upon programmes that, in the past, have shown effectiveness in facilitating reemployment.
- **Improve equality of opportunity and outcomes in education** by using targeted federal funding to reduce disparities in student opportunities and encourage States to be ambitious in lifting educational attainment. Require paid parental leave and improve access to quality childcare to help reduce wage gaps and improve career prospects. Expand the Earned Income Tax Credit and raise the minimum wage. Reduce pre-screening for employment on criminal records.
- **Improve the efficiency of the health care sector** by continuing to conduct pilot programmes of Medicare provider payment systems, assessments of utilised research by the Patient-Centered Outcome Research Institute and others that compares the effectiveness of different prescription drugs and treatments. Ensure that cost-saving measures thus identified are rolled out, and monitor their impact as well as developments in the coverage.
- **Reduce distortions in corporate taxes** by adopting legislation that cuts the statutory marginal corporate income tax rate and simplify corporate taxes and broaden the tax base. Make R&D tax credits refundable for new firms. Continue with measures to prevent base erosion and profit shifting.

Recent policy actions in these areas include:

- **The statutory marginal corporate income tax rate has been reduced** from 35% to 21%.