"Going for Growth" in Seven OECD Countries:

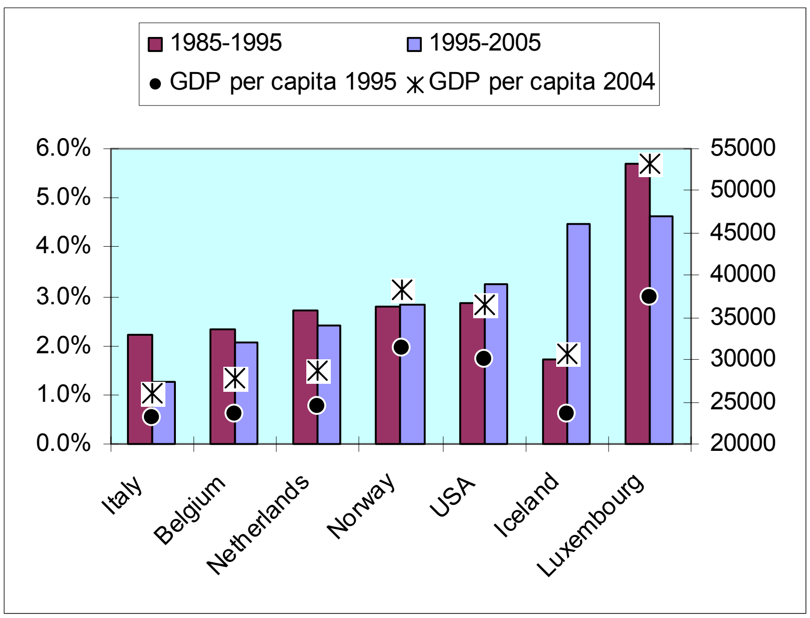
Patrick Lenain
Economics Department

Going for Growth in Seven OECD countries

Long-term growth trends of GDP per capita have differed

Over the past decade, long-term growth trends (as measured by GDP per capita) have differed across OECD countries. Output growth has increased in some countries, but it has slowed in others. Growth rates of per capita incomes declined in Belgium, Italy and the Netherlands, while they increased in Norway, the United States and Iceland. The pace of expansion has slowed in Luxembourg, but remained at a record level. As a result, the existing income gaps between countries have widened. Apart from Iceland, economies relatively less advanced have expanded less quickly than those that were initially farther ahead. This divergence has led to renewed interest for the determinants of long-term growth, and notably for government policies that have an influence on economic performance. Increasing GDP per capita is obviously not the only objective of governments, who strive to improve living standards and welfare more generally, but higher output increases their scope to attain these other goals.

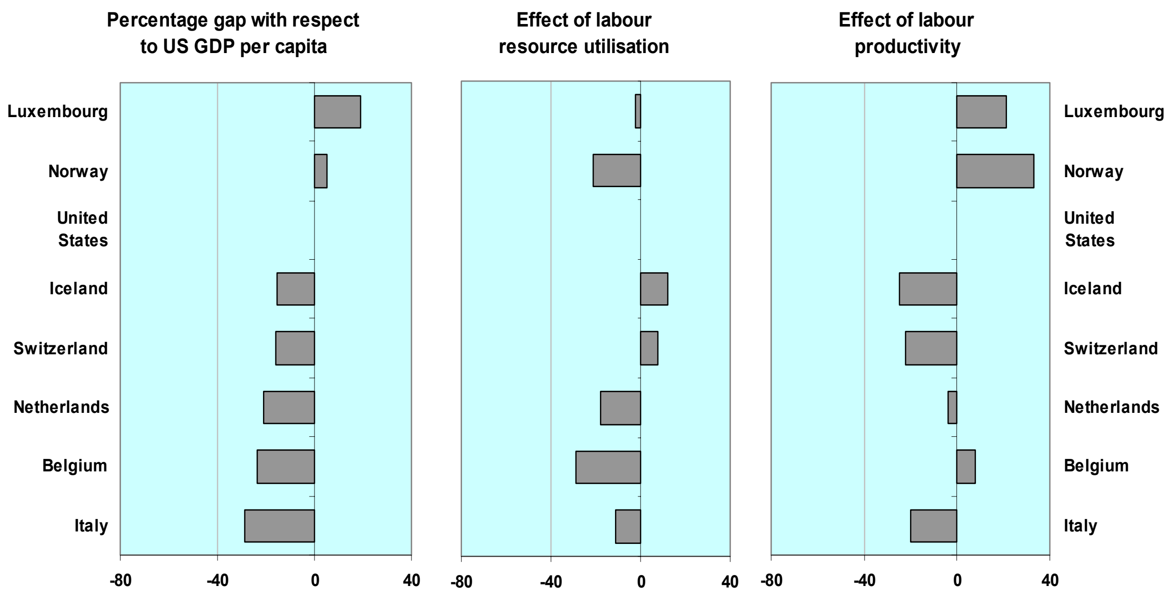
Long term growth trends have differed across countries



Two main factors explain international differences in income per capita

The gaps in GDP per capita *vis-à-vis* the benchmark country (the United States) can be broken down into contributions from labour productivity and labour utilisation. The gap in some countries relative to the United States is mostly accounted for by low labour utilisation (notably in Belgium, Italy and Norway). This reflects weak labour-force participation, high unemployment and/or short working hours. 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 unskilled workers showing up in comparatively high average output per person employed and output per hour worked. In other countries, the labour-productivity gap explains most of the weakness of GDP per capita. Low output per hour worked accounts for more than the whole of the GDP-per-capita gap in Iceland and has a substantially depressing effect in Italy. By contrast, labour productivity helps to raise the level of GDP per capita in Luxembourg because a predominant share of employment is concentrated in the high value-added sector of financial services. Similarly, the level of productivity in Norway is increased by the high share of activity in the energy sector, notably oil extraction.

The sources of real income differences, 2004



The OECD reviews growth-friendly policies in an annual report

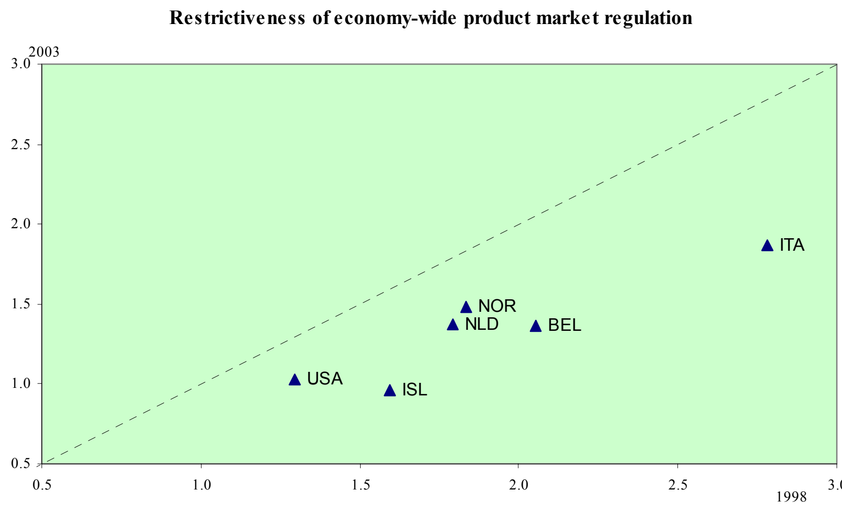
In order to better understand the role of government policies in economic growth, the OECD has developed a set of indicators that evaluate the economic performance and the effectiveness of structural policies of its member countries. An annual report published by the OECD since 2005, "*Going for Growth*", reports on the progress made by each country to implement growth-friendly policies. These policy priorities are identified based on the weak performance and policy settings that deviate from best practice in many areas.

Structural policies impacting on labour productivity

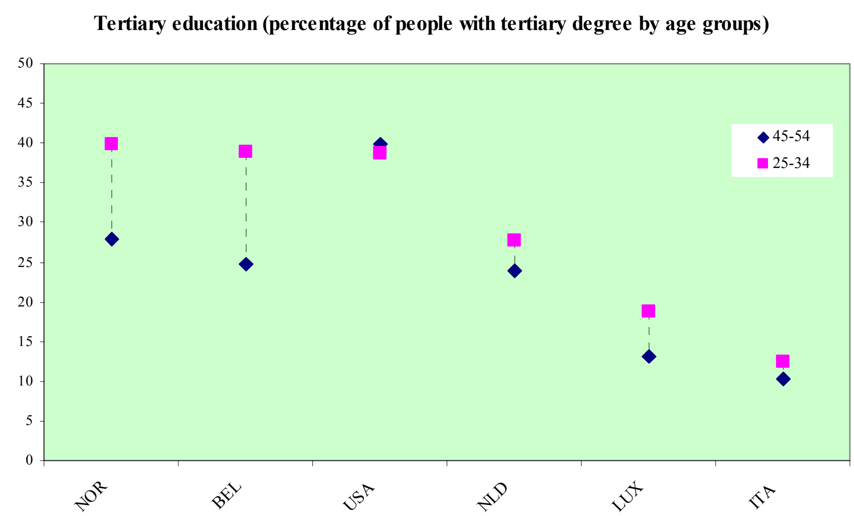
Labour productivity can be stimulated by structural policies that encourage profitable investment in physical capital and human capital, as well as in research and development. An area of particular relevance in this context is **regulatory policy**, such as state control, administrative or legal barriers to firm entry or international trade and FDIs. Indeed, given the potential efficiency gains, including stronger innovation activity, from exposing the business sector to intense competitive pressures, these are identified as one of the prime areas of policy priority to boost labour productivity. The OECD has developed a set of indicators to assess the strictness of product market regulatory policies. They are based on a survey, which has been made twice so far, in 1998 and 2003. The indicators range from 0 to 6 depending on the strictness of regulatory policies. There are significant differences across countries, which may help understand the differences in productivity levels. In general, these policies have become less restrictive between 1998 and 2003, but the ranking of countries has not changed dramatically.

Product market regulation

Index scale of 0-6 from least to most restrictive



Another policy area of major relevance for improving productivity performance is related to human capital development. 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. There are large differences across countries in the share of the population with a tertiary degree. In general, younger groups (25-34 year-olds) have obtained a tertiary degree to a larger degree than older groups (45-54), although this progress has not been made everywhere.



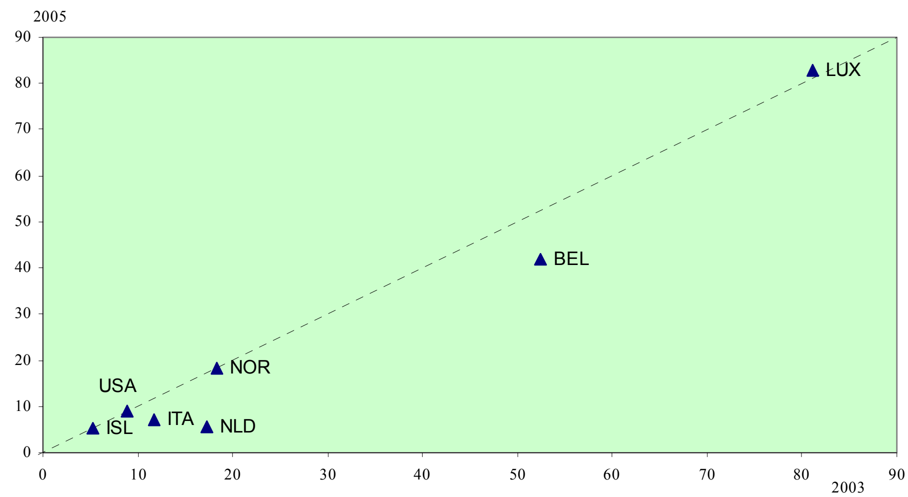
Source: OECD Education at a Glance, 2005.

Structural policies impacting on labour utilisation

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. Nevertheless, the mobilisation of labour resources remains impeded by policies that reduce the incentive to work. In particular, 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, the extent of the disincentive was very high in some countries in 2005, in particular for workers in their late 50s and early 60s.

Implicit tax on continued work: early retirement

Percentage of average worker earnings



There are other routes to exit the labour market before the official age of retirement. In various countries, early retirement uses the route of disability benefit schemes. While this may represent legitimate exits for workers having been subject to arduous working conditions, such schemes are often abused and have become implicitly early-retirement schemes, due to the lack of controls by the authorities. When there is no scheme in place to use the partial working capacity of disables or rehabilitation programmes to facilitate a (partial) return to work, such schemes often lead to permanent exits from the labour market. In Norway, where the official age of retirement is among the highest in the OECD (67-year-old), an increasing proportion of workers use the disability scheme to retire at an earlier age.

Income support for disability and sickness

Per cent of working age population non-employed and receiving disability benefits