Going for Growth 2007 – an inappropriate and misleading guide to increase productivity and to catch up with the US

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Economic Policy Reforms – Going for Growth 2007 is the third issue of an annual OECD publication designed to assist policy makers look for ways and to implement policies to achieve improved standards of living for their citizens. Starting point is the fact that over the past decade, the alleged gap in GDP per capita relative to the United States has widened in a number of countries, including the large continental European economies and Japan. In order to close the gap, the OECD has developed a benchmarking system based on a set of structural indicators in the areas of labour and product markets, which are – according to the OECD - supposed to do a reasonably good job at explaining economic performance. In particular, in line with previous issues, *Going for Growth 2007* examines performance indicators such as GDP per capita and its main components like labour utilisation and labour productivity. These components are in turn subdivided. Labour utilisation is broken down into overall rates of employment and number of hours worked per employee. Based on these indicators, *Going for Growth 2007* proposes a number of policy priorities for each OECD member country that it believes would help promote stronger economic growth. Based on the assertion that "*bad policies*" can explain weak GDP performance, the proposals boil down to policies aimed to further deregulate labour and product markets, to lower taxes, to extend working hours and to emulate the US model, allegedly the peak advanced economy.

US GDP per capita – a misleading benchmark for other OECD countries

TUAC would question whether it is appropriate to take the US as the model economy in a benchmarking focusing on GDP per capita. The US deficits on budget and current account have reached unprecedented levels. Whereas the US continues to be an excellent place to be rich, the promise of a better future is fading away for an increasing number of working Americans. As Bloomberg News reported in January 2007, the average pay for chief executives rose to 369 times that of the average worker in 2005. That was up from 131 times in 1993 and 36 times in 1976. The long-term trend toward greater inequality in the US can be observed in real wages as well as in broader measures of family well-being, such as real household income. For example, the share of income received by US households in the top fifth of the income distribution, after taxes have been paid and government transfers have been received, rose from 42 percent in 1979 to 50 percent in 2004, while the share of income received by those in the bottom fifth of the distribution declined from 7 percent to 5 percent. The benefits of growth and increasing productivity don't trickle down more than one American adult in five is in poverty, compared with one in fifteen in Italy.

More American adults are at work but they work longer hours than Europeans. According to the OECD a typical employed American put in 1804 hours in 2005, compared to 1435 for his or her German counterpart. Moreover, Americans take fewer paid holidays than Europeans.

However, unless they are well off, they don't get a fair deal for their efforts. For example, only a privileged minority has access to the best medical treatment in the world. But the number of Americans without health insurance is continuing to rise. According to the US Census Bureau their number went up 1.3 million from 45.3 million in 2004 to 46.6 million in 2005 - an increase from 15.6% to 15.9% of the country's population. The US health system is also the most costly in the OECD; current estimates put US healthcare spending at approximately 15% of GDP, the highest share across the OECD.

In addition, according to the U.S. Justice Department in 2005 there were 2,186,230 prisoners held in Federal or State prisons or in local jails, which corresponds about to 700 citizens per 100 000 behind bars. The ratio for Denmark for example is substantially lower; it is les than one tenth, i.e. 64 citizens per 100 000. Moreover, there is high and unsustainable energy consumption. By encouraging low population densities of metropolitan areas, US policies have contributed to traffic congestions, air pollution and commuting time. The US, which comprises just 5 per cent of the World's population, but it is responsible for about 25 percent of the world's greenhouse gas emissions per annum. And the American share is predicted to grow.

These are all concerns that have moved centre-stage for the US labour movement. The union supported "Shared Prosperity" programme run by the Economic Policy Institute (**http://www.SharedProsperity.org**) sets out a series of proposals designed to restore prosperity for US working families.

Structural Policy Reforms: No magic formula for economic growth and good employment performance

Policies designed and implemented to further deregulate labour and product markets, to lower taxes and to extend working hours are neither necessary nor acceptable formulas for economic growth and good employment performance. According to a study by the IMF, more that 240 labour market "reforms" have been implemented in Europe between 1985 and 2002. They were intended to decrease generosity of benefits, to weaken social protection and to increase rewards for moving from unemployment into employment. Many of them have been accompanied by product market reforms. (1) However, they have not automatically translated into stronger growth, higher productivity and lower unemployment.

The reassessment of the 1994 OECD Jobs Strategy has revealed that there is no robust correlation between labour market reform and employment performance. Some countries, not implementing the policies advocated by the OECD, have experienced a strong employment growth whereas others implementing the advocated policies have not been rewarded by a labour market performance. Moreover, the reassessment has revealed that the highly praised liberal labour market regimes have been outperformed by the more socially consensual labour market regimes in European countries, in particular in the Nordic countries. The evidence suggesting that a combined set of policies, rather than deregulating labour markets but focusing on active policies, is ignored by the new issue of *Going for Growth 2007*. Instead of advocating a more evidence based employment and labour market policy, *Going for Growth 2007* returns to the simplistic model of competitive labour markets. Contrary to the evidence provided by the *Employment Outlook 2006*, it reasserts that European firms respectively employers due to regulation lack the flexibility and adaptability of their US counterparts. What is particularly striking in this aspect is the fact that *Going for Growth 2007* recommends to two relatively successful countries, namely Luxembourg and Sweden, to reduce the alleged cost of Employment Protection Legislation (EPL). The need for action in the case of Luxembourg is hard to explain, the country enjoys a positive gap with regard to GDP per capita as well as a higher productivity than the US. That, however, does not prevent the OECD from urging the government of Luxembourg to ease EPL. The same applies to the recommendation to reduce the alleged cost of EPL. These cost, if there are any at all, have not prevented the Swedish economy to perform better than some of the economies with more liberal regimes, among them the UK and New Zealand.

Table: High investment in active labour market policy pays off - Different regimes of labour market functioning

	Central and North European welfare states [a]	Countries with liberal labour market regimes [b]	OECD unweighted average
	Strong interventionism	Low interventionism	
Unemployment rate	4.79	5.30	7.47
Employment rate	71.91	70.92	67.11
Relative poverty rate [c]	7.77	11.78	9.64
Union coverage	83.33	30.75	59.96
Employment protection legislation	2.13	1.38	2.01
Generosity of unemployment benefits [d]	39.96	18.23	27.81
ALMP spending (percentage of GDP)	1.31	0.39	0.76

a) Includes Austria, Denmark, Ireland, the Netherlands, Norway and Sweden
b) Includes Australia, Canada, Japan, Korea, New Zealand, Switzerland, the UK and the US
c) Portion of the population with income below 50% of the current median income
d) Average unemployment benefit replacement rate across different earnings and family situations

Source: OECD Employment Outlook 2006, p. 191

Deregulated product and labour markets don't guarantee competitiveness and high productivity

A further concern not taken account of by *Going for Growth* is the relationship between deregulation of labour markets and productivity. The structural performance of the UK economy provides a case in point in this respect. According to the OECD, the UK economy enjoys the least regulated framework regarding labour and product markets within Europe. That however is, contrary to the predictions, not reflected in the productivity performance. There remains a serious productivity puzzle. The level of productivity of the British economy is not only lower than in the US. It is also substantially lower than in France and Germany, countries with rather dense regulations of labour and product markets.

The puzzling fact that Britain's productivity gap has remained fairly large is not addressed by the OECD. It reveals that the approach pursued by the OECD is rather limited. Facts and figures provided by *Going for Growth 2007* reveal that between European countries exists a considerable diversity in terms of both productivity as well as comparative levels. In order to understand the European cross-regional diversity in productivity, an industry perspective with regard to output, input and productivity performance must be adopted. In the words of one commentator "There is a need to go beneath the aggregate numbers to ascertain to what extent variations across countries are largely explained by differences in industry structure." (2) Better productivity performance requires first and foremost a set of policies promoting R&D,

the diffusion of new technology, the redesign of work systems as well as active labour market policies facilitating the retraining of workers and the acquisition of new skills, not more labour market deregulation.

(1) Boeri, T. (2005) Reforming Labor and Product Markets: Some Lessons from Two Decades of Experiments in Europe, IMF Working Paper WP/05/97
(2) Ark, B. Van (2005) Europe's Productivity Gap: Catching Up or Getting Stuck? The Conference Board. New York, p. 5