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HOW TO MAKE SENSE OF THE STRUCTURAL REFORM LISTS FOR THE EURO AREA

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SUMMARY

The euro area still suffers from low growth rates, macroeconomic imbalances and divergence. Therefore, the European Commission, the ECB, the IMF, and the OECD have **all called for more structural reforms in the euro area.** Adding up all recent key reform recommendations by the European Commission and the OECD alone amounts to **more than 200 recommendations for the 19 euro-area countries.**

In this jungle of recommendations setting the right priorities is important. This policy paper presents an approach on **how to use the long list of reform recommendations.** It presents a structured summary of the key reform recommendations for the euro area, puts forward three reform priorities for each euro area country and presents an overview of the reforms on a single page. Such a procedure is necessarily controversial. But we want to bring some clarity and structure into a debate that is all over the place. We arrive at **three key conclusions:**

First, **product market reforms with a focus on enhancing the Single Market** should be the top priority now. They have the highest short-term gains, can be implemented in good and bad economic times, have the largest effects on potential growth and can contribute significantly to the functioning of the euro area.

Th**e second reform priority should be to boost investment** as the euro area suffers from a significant investment gap. Countries with fiscal space should directly invest in education, research and investment. Investments here count as reform in the sense that they change the structure of the economy.

Third, the high rates of unemployment in many euro-area countries are a source of concern. However, labour market reform should be implemented with great care: They can have transitional costs in the short term and benefits may take longer to materialize. Moreover, some of the reforms do not work well in times of weak economic growth and there are potentially powerful veto players to counter reform efforts. In addition, product market reforms can go a long way in increasing employment and restoring competitiveness. If labour market reforms are implemented, **reforms should have a demand-side component to stabilize the economy**, such as investment in education, vocational training, ALMPs and life-long learning.

The timing and method to implement reforms need to take into account the **broader economic circumstances as well as distributional effects and social cohesion.** Our key **take-home point** is that not the most frequently mentioned reforms should be implemented, but the ones that fulfil the objectives of increasing growth and improving the functioning of the euro area also in difficult economic times.

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The authors would like to thank Philipp Ständer for excellent research assistance.

1. What are structural reforms and why are they important?

1.1. What are structural reforms?

There is a lot of disagreement about the term "structural reforms". Many prefer not to use it as it is considered to reflect a certain ideological orientation. We argue that the term can be meaningfully applied as long as it is well-defined. For us, structural reforms are all government-driven reforms that improve the functioning of the economy with the aim of leading to higher long-term GDP. Whether higher GDP should be an objective in itself is of lesser relevance here. We consider a higher GDP to be generally positive as long as negative externalities are properly taken into account. But the debate about structural reforms should not be a debate on whether higher GDP is good, but how to get there, should higher GDP be desired. In the euro area context, an improved functioning of the single currency area thanks to structural reforms would also fall under our definition as we would expect euro area GDP to increase as a consequence in the longer term.

"WHEN IT COMES TO ECONOMIC POLICY, STRUCTURAL REFORMS ARE OFTEN SYNONYMOUS WITH SOUND ECONOMIC POLICY. BUT HOW DO WE RECOGNIZE A GOOD STRUCTURAL REFORM WHEN WE SEE IT?"

Typical structural reforms fall into the area of labour markets, product markets and the financial sector, as well as taxation and public sector reforms. At their best, structural reforms may be budget-neutral or even save money. These features have led some to argue that structural reform recommendations are conceptually empty or "[s]afe advice. No one knows what it means. If economy grows: I told you. If it stalls: You didn't do structural reform."[1] The quote by Kaushik Basu, Professor of Economics at Cornell University and former Chief Economist of the World Bank, highlights both the power and confusion surrounding the concept of structural reform: When it comes to economic policy, structural reforms are often synonymous with sound economic policy. But how do we recognize a good structural reform when we see it?

Clearly, when looking at the long lists of reform recommendations (that put forward hundreds of reforms for euro-area countries alone) it seems that governments should know what to do. At the same time, the implementation gaps are significant: Only a handful of reforms have been implemented in the last years.[2] On almost half of the key recommendations there has been no progress at all. This could be due to the context of economic crisis. Indeed, even strong proponents of structural reforms such as the IMF now recommend paying more attention to the macroeconomic context.[3] There has been a notable shift from focusing on what one might call the traditional reform agenda to more emphasis on the difference between bad and good economic times, the role of the demand-side, and social cohesion. In this context, making reform recommendations and prioritising them has become even more challenging.

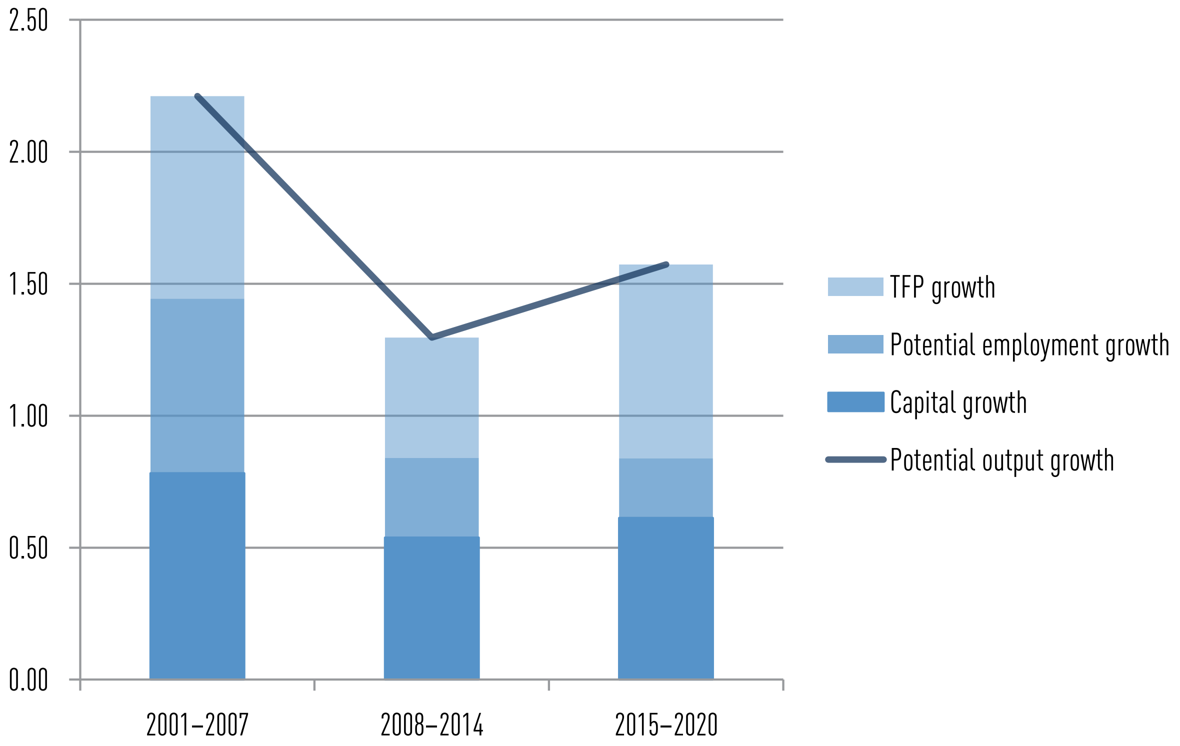
This paper explains why structural reforms are important for the euro area from a theoretical standpoint. Second, it analyses more than 200 key reform recommendations and collapses them into two summary reform lists with five areas of reform in each list. Third, with the help of insights from empirical research it identifies three reform priorities for each euro-area country.

1. See tweet of Kaushik Basu, Professor of Economics at Cornell University and former World Bank Chief Economist, on 7 April 2016 at 10:33 pm.
2. For recent evaluations see: OECD, "Structural Reforms in Europe: Achievements and Homework", "Better Policies" Series, April 2015; European Parliament, Country Specific Recommendations (CSRs) for 2015 and 2016: A comparison and an overview of implementation, 9 September 2016.
3. R. Duval and D. Furceri (lead authors), "Time for a Supply-Side Boost? Macroeconomic Effects of Labor and Product Market Reforms in Advanced Economies", in: IMF, World Economic Outlook: Too Slow for Too Long, Ch. 3, April 2016; and OECD, Going for Growth: Interim Report, 2016; A. C. Sánchez et al., "Reforming in a difficult macroeconomic context", OECD Economics Department Working Papers No. 1297, OECD Publishing, Paris, 2016.

1.2. Why structural reforms are important for growth

The recovery after the crisis has been slow and the euro area is stuck in a difficult situation: low growth, low inflation and high unemployment. In terms of potential output most advanced economies have not recovered from the crisis: potential growth is still below pre-crisis levels.[4] Figure 1 reproduces estimates from the IMF.

FIGURE 1 ► Lost years for growth in advanced economies



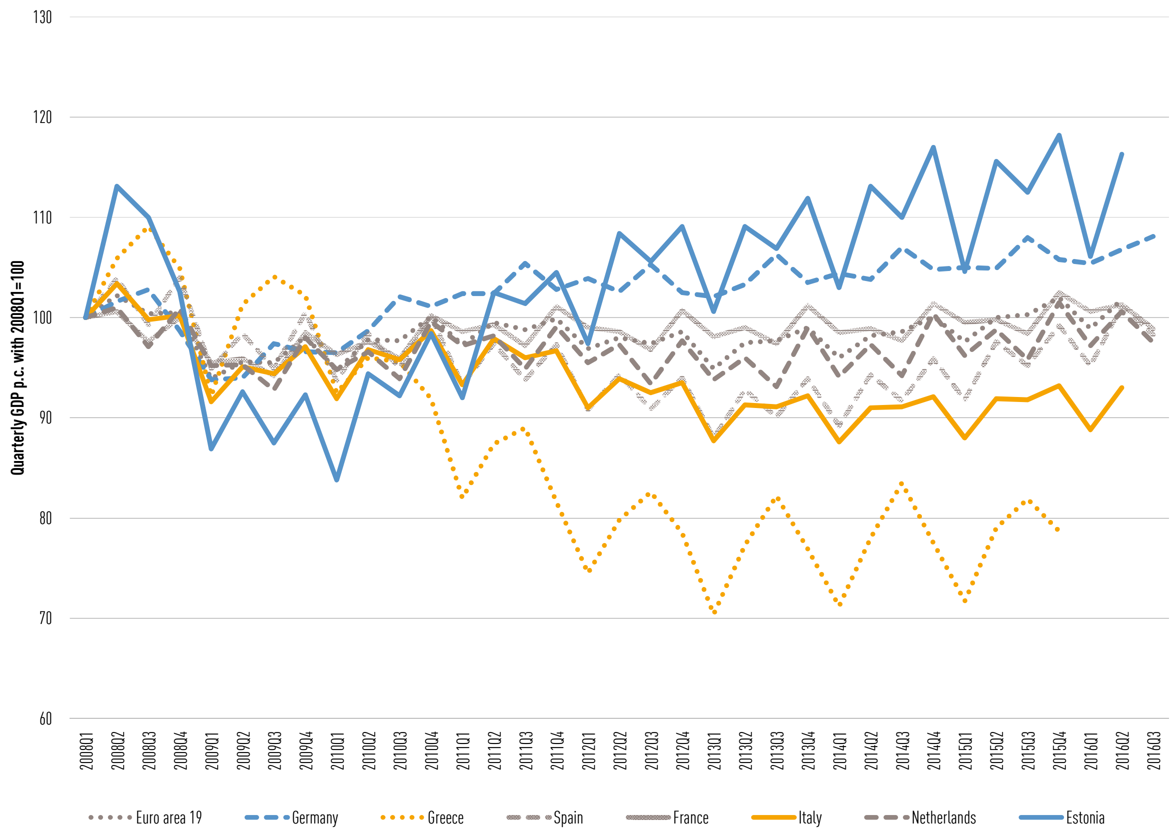
Source: IMF (2016), Figure 3.1.
Figure shows potential output growth and its components for advanced economies.

Growth rates in the euro area are still too low. As figure 2 shows, some countries have not recovered from the crisis. Of the 19 euro-area members four have still lower GDP per capita in 2016 than in 2008. The Baltic States and also Germany have grown faster; France and Spain have witnessed a slower recovery; Greece and Italy are on a downward trend.

Not surprisingly, unemployment rates in November 2016 stood at 9.8 percent on average.[5] Again this conceals the vast differences within the euro area: Spain's unemployment is just below 20 percent, while Germany's unemployment rate amounted to a little more than 4 percent. On top of that, inflation is still low: The annual HICP inflation rate for December 2016 stood at 1.1 percent.[6]

4. IMF (2016), Figure 3.1.
5. Eurostat, unemployment rate by sex and age, monthly average, seasonally adjusted estimate.
6. European Central Bank, Statistical Data Warehouse, Selected Indicators for the Euro Area.

FIGURE 2 ► In some euro-area economies recovery has come to a halt



Source: Eurostat (variable namq_10_pc), authors' calculation.
Figure shows quarterly unadjusted chained GDP per capita for selected countries (2008Q1=100).

While structural reforms, shifting aggregate supply, can in theory lead to a tendency for prices to fall, the general growth dynamic triggered by reforms is of paramount importance, especially in the context of a highly accommodative monetary policy. As the ECB often argues, the currently supportive demand-side conditions should be used by governments for structural reforms.

The positive economic effects of reforms work through three main channels: (i) employment, (ii) productivity, and (iii) potential output in the long-run.[7] Most reforms have spill-over effects across more than one of these areas, but one can categorize them broadly into these three categories.

First, there are a number of reforms that have direct effects on **employment**. We simply describe these reform areas here without making a normative assessment whether such reforms are desirable.

- **Reforms that lower the reservation wage**, such as the harmonization of employment protection legislation (EPL) for temporary and permanent workers, tax reforms of second-earner penalties, a reduction of the labour tax wedge, a reduction of high and unconditional unemployment benefits, a revision of early retirement schemes and pension reforms that increase the pension age and offer more flexible transition periods into retirement.

7. For some recent empirical evidence see for instance: Andersen *et al.*, "Assessing the Gains from Structural Reforms for Jobs and Growth", in IMF: *Jobs and Growth: Supporting the European Recovery*, Ch. 7, 2014; R. Duval and D. Furceri (2016); ECB, "Progress with structural reforms across the euro area and their possible impacts", *Economic Bulletin* Issue 2, 2015; ECB, "The short-term fiscal implications of structural reforms", *Economic Bulletin* Issue 7, 2015; J. Varga and J. Veld, "The potential growth impact of structural reforms in the EU – a benchmarking exercise", European Commission: *European Economy, Economic Papers* No 541, December 2014.

- **Reforms that allow labour market outsiders to enter the market and thus increase the overall labour supply**, such as the provision of child care for parents, language classes for migrants, vocational training for young individuals, life-long learning programs for the elderly and active labour market policies (ALMP) for the unemployed. These reforms can increase the labour market participation especially of women, elderly people, migrants or workers, whose skills are no longer in demand due to structural change.

Second, there are structural reforms that are directly targeted at increasing **productivity**:

- **Reforms to reduce barriers to entry to increase competition and lower prices** such as the opening of closed professional services, harmonization of regulations and reduction of regulatory barriers and red tape.

- **Reforms to increase market efficiency through digitalization**, facilitated by increasing competition in the telecoms sector leading to more ICT investment, harmonizing spectrum allocation and allow for EU-wide auctions for licenses, and encourage EU-wide standards for connected factories.

- **Reforms that increase the skill-level**, such as investment into early-childhood education, school and university funding, vocational training and R&D funding.

Third, some reforms have direct effects on the **growth potential**:

- **Reforms that increase competitiveness in trade** such as making the wage-bargaining system responsive to changes in productivity, increase of competition in product and service markets that lower prices.

- **Reforms that improve the efficiency of the taxation process**, such as enforcing tax compliance to increase the tax base, shifting taxation from labour to more growth friendly taxes such as environmental tax, and reducing government administration and expenditure where possible.

- **Reforms that reduce uncertainty in the market and thereby increase investment** such as an overhaul of the judicial system and bankruptcy regulations, as well as reduction of regulatory uncertainty.

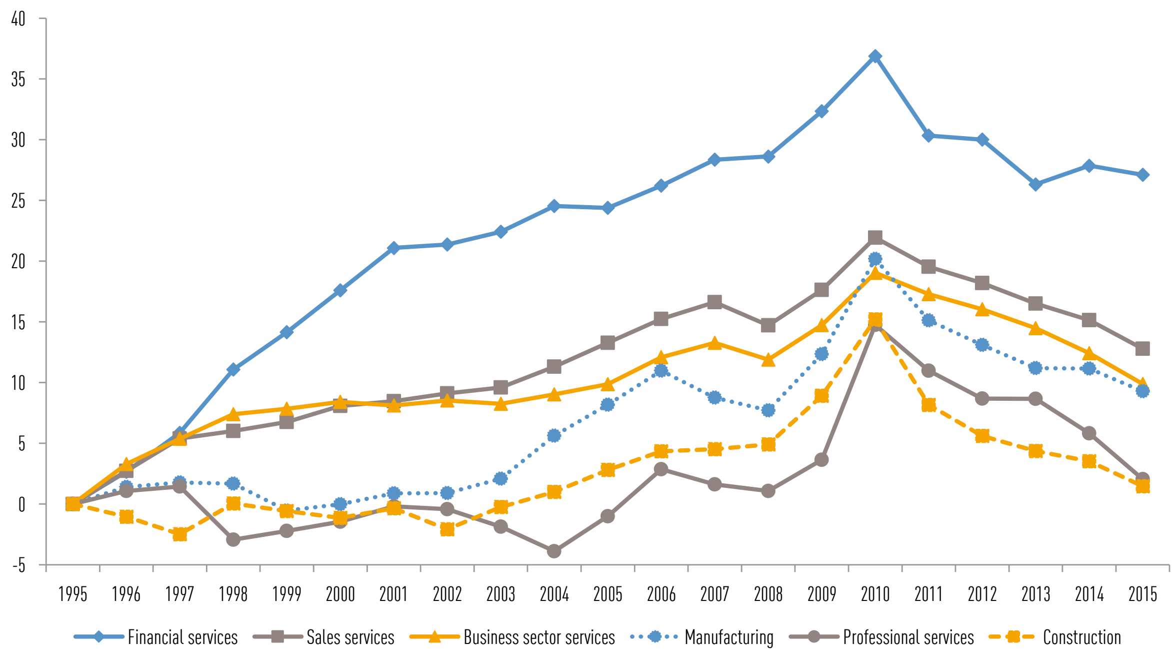
Taken together, these theoretical arguments for more structural reforms in the euro area to increase growth, both directly and indirectly, are compelling. Given the weak recovery after the crisis, there is room for reforms.

1.3. Why structural reforms matter for the euro area

In addition, structural reforms are important for the functioning of the euro area. There are two main reasons for this[8]: First, there are still large macroeconomic imbalances in the euro area and the economies are set on a trajectory of divergence: Business cycles are not synchronized as different empirical studies have shown.[9] Inflation differentials and the competitiveness divide have fallen since the crisis but remain significant.[10]

Figure 3 depicts differences in unit labour costs across selected sectors in the euro area. It shows that the largest wage growth differentials did not occur in manufacturing or construction, but in the service sectors, including financial and insurance services, sales services and business sector services. The finding that wage growth in the sheltered sectors was much larger than in the exposed sector and that the sheltered sector is mainly composed of the service sector is confirmed by other research.[11]

FIGURE 3 ► Sectoral divergence in wage growth in the euro area



Source: OECD Dataset: Productivity and ULC by main economic activity (ISIC Rev. 4, International Standard Industrial Classification of All Economic Activities), authors' calculation.
Figure shows differences in unit labour cost growth in the euro area 19 (no data for Malta and Cyprus) for selected economic activities, based on standard deviation in wage growth, 1995=0.

These imbalances pose a problem for the common monetary policy of the European Central Bank. It sets only one interest rate for the whole euro area. If business cycles in the euro area are not synchronised, this interest rate will be too high for countries that are currently in an upswing, exacerbating the boom, and too low for a country in recession, deepening the slump.[12]

8. Compare E. Rubio, "Promoting Structural Reforms in the Euro Area: What For and How?", *Policy Paper* No. 119, Notre Europe – Jacques Delors Institute, 14 October 2014.
9. J. de Haan, R. Inklaar and R. Jong-A-Pin, "Will business cycles in the euro area converge? A critical survey of empirical research", *Journal of Economic Survey* 22(2): 243-273, 2007; D. Giannone, M. Lenza, and L. Reichlin, "Business cycles in the euro area", *ECB Working Paper Series* No. 1010, 2009; F. Ferroni and B. Klaus, "Euro area business cycles in turbulent times: convergence or decoupling?", *ECB Working Paper Series* No 1819, June 2015.
10. A. auf dem Brinke *et al.*, What kind of convergence does the euro area need?, Gütersloh: Jacques Delors Institut – Berlin and Bertelsmann Stiftung, 2015.
11. A. Johnston, "European Economic and Monetary Union's perverse effects on sectoral wage inflation: Negative feedback effects from institutional change?", *European Union Politics* 12(3), 345-366, 2012; D. Hanzl-Weiss and M. Landesmann, "Correcting External Imbalances in the European Economy", *wiiw Research Report* No. 410, April 2016.
12. Compare H. Enderlein, "One Size Fits None", *Central Banking* XVI. 1 August 2005.

The second reason for why structural reforms are important for the euro area rests on optimal currency area theory. The architects of the Economic and Monetary Union knew that market integration was not only a desired by-product of monetary integration, but a necessary component. The real exchange rate channel is thereby of crucial importance:[13] If one euro area country grows faster than the others, expectations adjust and workers will ask for higher wages. Higher wages will translate into higher prices. Inflation rises. This reduces the competitiveness vis-à-vis the trading partners. The real exchange rate appreciates. Exports fall, while imports increase. In the next wage-setting round, wages will be cut. This will reduce aggregate domestic demand. Inflation falls. The economy is back in equilibrium. In other words: the real exchange rate channel corrects imbalances after an asymmetric shock.

> **"STRUCTURAL REFORMS THAT INCREASE THE RESPONSIVENESS OF PRICES AND WAGES TO THE MARKET STABILIZE THE EURO AREA."**

For the real exchange rate channel to work, markets have to be fully integrated. Wages and prices should not be sheltered from competition. Incomplete markets, sheltered sectors and a high share of non-tradable products hamper the functioning of the real exchange rate channel. Structural reforms that increase the responsiveness of prices and wages to the market stabilize the euro area.[14] They reduce inflation differentials and the competitiveness divide.

In theory, structural reforms can help to improve the functioning of the euro area.[15] Among them are:

- **Reforms that facilitate the cross-border integration of product markets** such as harmonization of regulation, opening up sheltered sectors, deregulating closed professions and reduction of red tape.

- **Reforms that increase the flexibility of wages and employment** such as wage bargaining on plant-level and employment protection legislation reform that allow employers to react to upswings and downturns of the economy, reforms that increase labour mobility such as benefit portability and degree recognition.

- **Reforms that help economies to recover after a recession by increasing investment** such as public private partnerships, reduction of regulatory uncertainties and public spending on infrastructure and education.

Economic theory provides a strong case for euro-area countries to implement structural reforms both to get the growth engine back on track and to improve the functioning of the common currency area: Growth rates are still low and potential growth has not yet recovered. The euro area is an imperfect currency area with an inefficient allocation of existing resources. Falling productivity growth, already before the crisis, and weak investment both public and private are widespread. At the same time, the working age population in Europe is shrinking. The current generation ready to enter the labour market may be the best educated so far (at least in terms of years spent in education) but high youth unemployment rates pay testimony to how badly Europe is failing to integrate them into the labour market. The next section looks at the recommendations on the table.

13. See for example H. Enderlein *et al.*, Completing the Euro: A road map towards fiscal union in Europe, Report of the "Tommaso Padoa-Schioppa Group", *Notre Europe: Studies & Reports* No. 92, 2012; S. Dullien, U. Fritsche, I. Größl, & M. Paetz, "Adjustment in EMU: Is convergence assured?", *DEP Discussion Papers Macroeconomics and Finance Series*, 2009.
14. For more on how structural reforms could feature in a reform agenda for the euro area see: H. Enderlein, E. Letta *et al.*, Repair and Prepare: Growth and the Euro after Brexit, Gütersloh, Berlin, Paris: Bertelsmann Stiftung, Jacques Delors Institut – Berlin and Jaques Delors Institute in Paris, 2016.
15. See also A. auf dem Brinke *et al.*, "Why the eurozone can't agree on convergence, and how structural reforms can help", *Policy Paper* No.165, Jacques Delors Institut – Berlin, 24 May 2016.

2. What are the recommendations?

2.1. How to make sense of laundry lists

The four most important actors in the field of structural reforms in the euro area – the European Commission, ECB, IMF, and OECD – call for more reforms. There is almost an abundance of reform recommendations. As a result, these laundry lists may seem too complex to produce meaningful policy results. While the number of structural reform recommendations may be high and confusing, this section attempts to identify clear policy priorities. It proceeds in three steps:

First, this section starts with a frequency count: How many reform recommendations are there for each country? This shows which countries have the largest reform backlog and are in need of reform. Second, it examines whether there is consensus when it comes to the key reform recommendations.[16] This allows us to identify a smaller number of reform priorities for each country and the euro area as a whole. Third, the reforms are grouped into five areas product market, financial sector, labour market, taxation and public sector) distinguishing again between consensus and no consensus reform recommendations. Based on this we can identify areas where reforms are most needed and compare reform patterns across countries. In short, this section tries to condense the more than 200 reform recommendations into two short lists of five reform areas each: The first list summarizes reforms that should have already been implemented: unfinished business. The second list comprises next generation reforms that are more forward-looking.

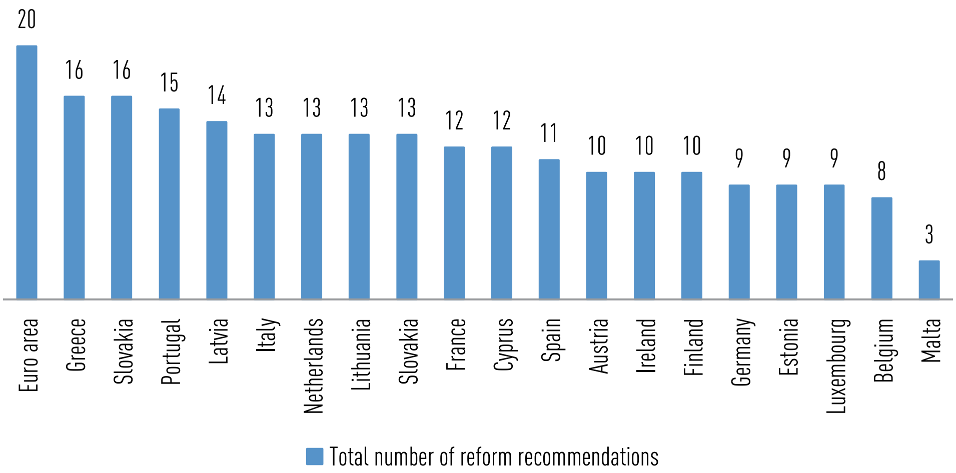
2.2. Deriving consensus reform lists

„TAKEN TOGETHER THE MOST RECENT KEY RECOMMENDATIONS ADD UP TO 236 REFORMS FOR THE EURO-AREA COUNTRIES."

There are many different publications that demand more reforms. To compare two consistent sets, this paper focuses on two reoccurring publication series: the OECD Economic Surveys and the country-specific recommendations of the European Commission.[17] Taken together the most recent key recommendations add up to 236 reforms for the euro-area countries. Figure 4 shows the breakdown of numbers by countries. Not surprisingly, the most reform recommendations were issued for the euro area (20) as a whole. The countries with the longest lists of key reforms were Greece (16), Slovakia (16), Portugal (15) and Latvia (14). The fewest recommendations were received by Germany, Estonia and Luxembourg (9 each), as well as Belgium (8).[18] The frequency count shows that all countries have scope for structural reforms, and that the countries, which still have not fully recovered after the crisis, have received a longer list.

16. For each country we compare the recommendations of the latest OECD Economic Surveys (published between 2014 and 2016) with the Country Reports 2016 of the European Commission (published in February 2016 and based on the 2015 CSR cycle). These two series have been selected because they provide a European and international perspective, produce regularly systematic reform recommendations, and have directly comparable key recommendations.
17. See appendix for a complete list of all references by country.
18. Malta has very few recommendations (3), partly because it is not covered by the OECD.

FIGURE 4 ► **Counting key reform recommendations: in total more than 230**



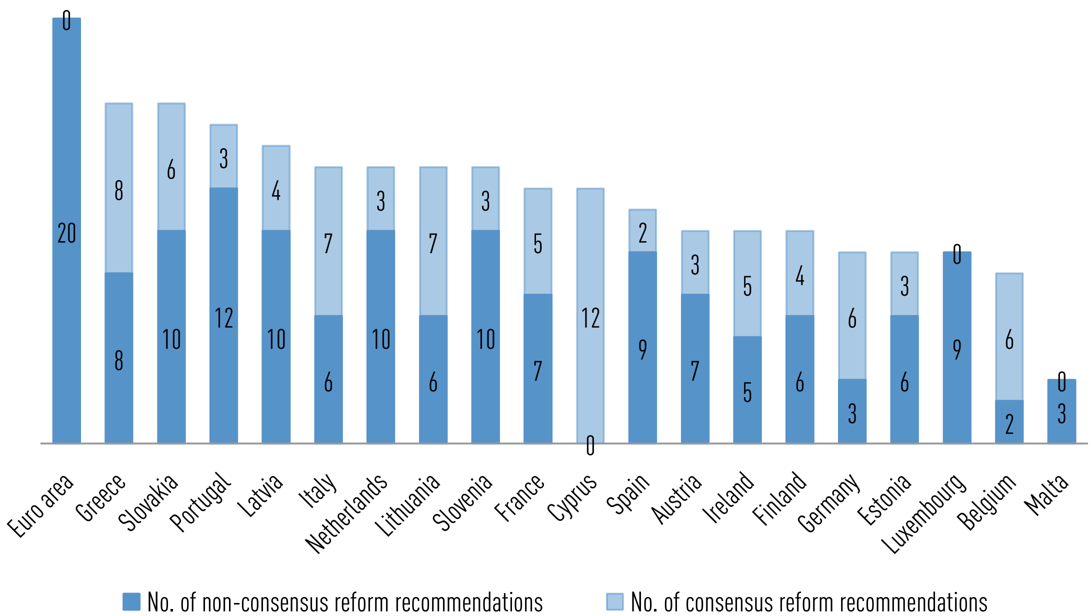
Source: Based on the latest reform recommendations from the country studies in the latest OECD Economic Surveys and the CSRs in the country reports from February 2016 by the European Commission (please see appendix for details), compiled by authors.

How much do key reform priorities overlap? While in terms of general diagnostics, the difference between the main actors is more in emphasis than in substance, the actual reform recommendations overlap by less than 40 percent. Because the European Commission and the OECD are in regular contact about their reform recommendations one could have expected a greater overlap. Yet at the same time, they have tended to set different priorities in their recommendations.

> "WHILE IN TERMS OF GENERAL DIAGNOSTICS, THE DIFFERENCE BETWEEN THE MAIN ACTORS IS MORE IN EMPHASIS THAN IN SUBSTANCE, THE ACTUAL REFORM RECOMMENDATIONS OVERLAP BY LESS THAN 40%."

The two countries still under a macroeconomic adjustment program, Cyprus and Greece, have the highest number of consensus reform recommendations, as figure 5 depicts. This is due to the fact that both countries have been under a macroeconomic adjustment programme with a detailed Memorandum of Understanding and have received more recommendations than in the CSRs. But also for Italy (7) and Lithuania (7) there is a consensus on what has to be done next. For Spain there is more disagreement with only 2 key reforms that are advocated by both the OECD and the European Commission. Countries with fewer reform recommendations in total have larger overlap, as can be seen in the cases of Germany (6) and Belgium (6).

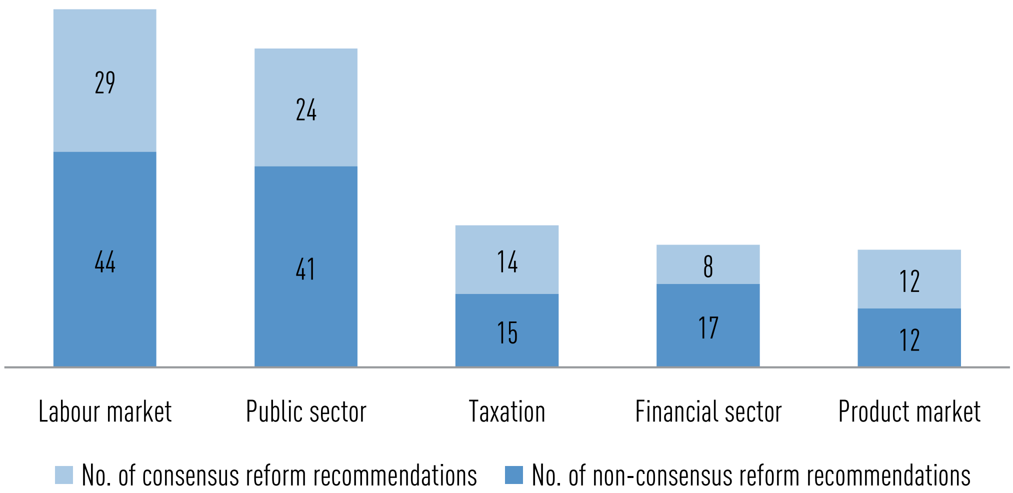
FIGURE 5 ► **Consensus on reform priorities for euro-area countries is less than 40%**



Source: Based on the latest reform recommendations from the country studies in the latest OECD Economic Surveys and the CSRs in the country reports from February 2016 by the European Commission (please see appendix for details), compiled by authors.

Reform recommendations can be sorted into five areas. Figure 6 shows the number of key reform recommendations by areas. Most reform recommendations concern the labour market (73), followed by public sector reforms (65), which include all reforms that alter how the public sector works including investment, social benefit reforms, public employment reforms and reforms of the judicial service. Fewer recommendations fall into the areas of taxation (29), the financial sector (25) and the product market (24). There are almost three times as many labour market reform recommendations than product market reform recommendations.

FIGURE 6 ► There were three times as many country recommendations for labour markets than product markets



Source: Based on the latest country reform recommendations from the country studies in the latest OECD Economic Surveys and the CSRs in the country reports from February 2016 by the European Commission (please see appendix for details), compiled by authors.

In a last step, let us look at reform contents.[19] One can see that although all countries receive tailored advice, the recommendations themselves are not that different. It is possible to identify two distinct reform lists: unfinished business and next generation reforms. The list of unfinished business should be completed, and if possible, coupled with reforms from the next generation list. Most countries can follow one of the reform blueprints: seven countries from the euro area should focus on their unfinished business first, seven other countries should fully embark on the next generation reform measures. For five countries, there could be a mix with elements from both lists. Figures 7A and 7B provides a short and simple overview of all reform recommendations by area and country.[20]

19. See appendix tables A1 and A2 for the complete list of all reform recommendations, and table A3 for a summary of the consensus reform recommendations.
20. See appendix tables A1 and A2 for the complete list of all reform recommendations, and table A3 for a summary of the consensus reform recommendations.

FIGURE 7A ► **Consensus reform lists: unfinished business and next generation**

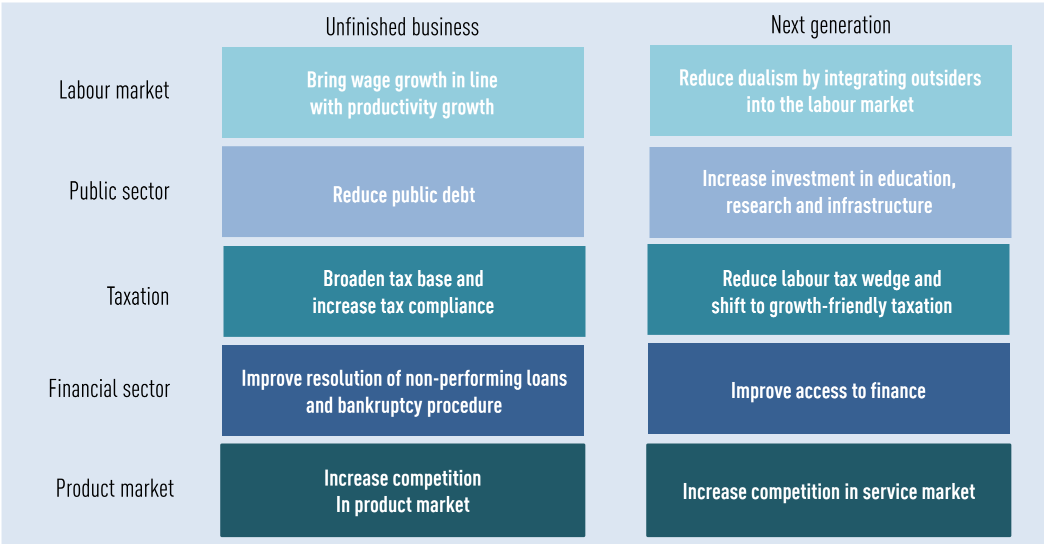
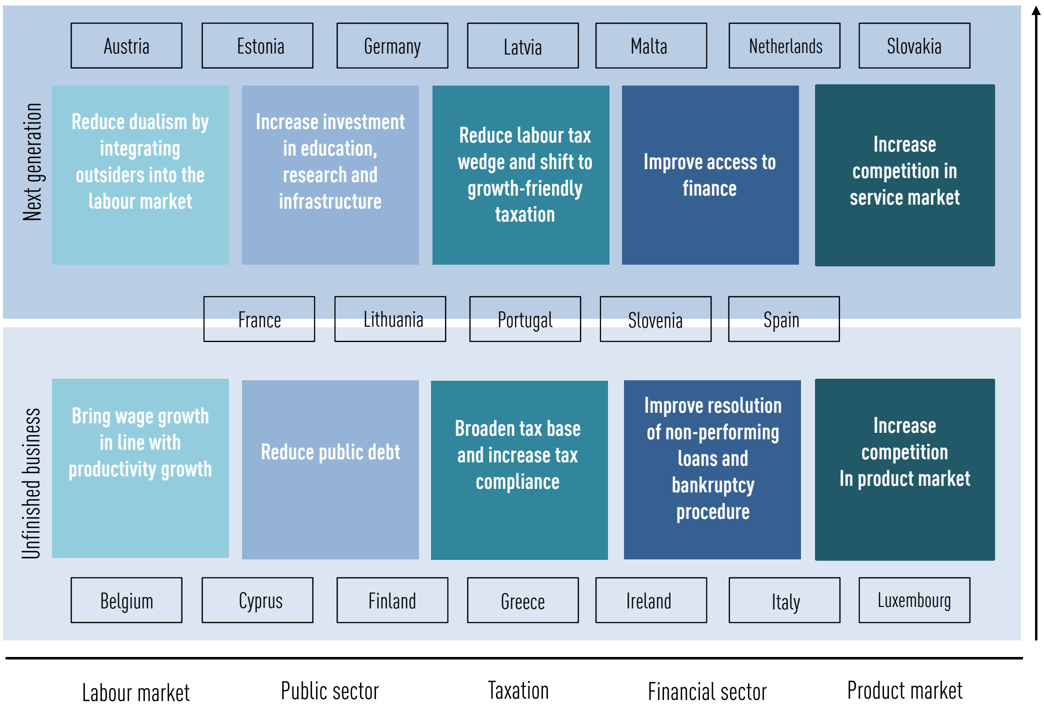


FIGURE 7B ► **Consensus reform lists: where the countries are**



Source : Authors.

The unfinished business lists consist of policies that can be implemented even if there is no or little fiscal space because public deficit and debt are too high. The five recommendations are to increase competition in the product market, to improve the resolution of non-performing loans and bankruptcy procedures, to help bring wage growth in line with productivity by installing an effective framework for wage bargaining, and reducing EPL, broadening the tax base and enforcing tax compliance and reduce public debt. These reforms are still relevant for Belgium, Cyprus, Finland, Greece, Ireland, Italy and Luxembourg. While these reforms may make sense from a theoretical perspective, how to implement them remains a puzzle.

In addition, we have a list of new reform recommendations. The concrete reform measures are to increase competition in the service market, especially by deregulating closed professional services, improving access to finance (particularly for SMEs), integrating outsiders (including young and old workers, women and immigrants) into the labour market by offering more targeted training through vocational schemes and ALMPs, reducing the labour tax wedge and shifting taxation to a consumption or environmental tax, and finally (if there is fiscal space) increasing investment into education, research and infrastructure. Austria, Estonia, Germany, Latvia, Malta, the Netherlands and Slovakia could primarily turn to the next generation list.

According to the analysis, France, Lithuania, Portugal, Slovenia and Spain are clearly in-between the two lists and need reform from both lists. France should follow the unfinished business list when it comes to labour market policies and public debt, and follow the next generation list with regards to the product market and taxation. Lithuania should integrate outsiders into the labour market but at the same time also broaden the tax base and fight tax evasion. Portugal needs to alleviate poverty and scale-up the ALMPs. Slovenia has to tackle its non-performing loan problems in the banking sector and facilitate restructuring, while at the same time address the problem of integrating long-term unemployed and low-skilled individuals into the labour market. Spain still has to restructure and privatize banks, but should also work on increasing competition in the service sector.

To sum up, although there is still some unfinished business which needs to be taken care of, countries may concentrate, where possible, on the next generation list because these reforms are forward-looking, and focus on how to be regulating the new economy including the digital sector, be innovative and integrate the younger generations into the labour market. Reforms on that list have a demand-side component and help to stimulate growth in the euro area. The focus of these reforms it to push out the production possibility frontier and to move from consolidation to stimulation of the economy. Still, unfinished business reforms remain important and their implementation a challenge. Where possible, we might think about how to couple them with reforms from the next generation list. This is what the next section is about.

“COUNTRIES MAY CONCENTRATE, WHERE POSSIBLE, ON THE NEXT GENERATION LIST BECAUSE THESE REFORMS ARE FORWARD-LOOKING, AND FOCUS ON HOW TO BE REGULATING THE NEW ECONOMY INCLUDING THE DIGITAL SECTOR, BE INNOVATIVE AND INTEGRATE THE YOUNGER GENERATIONS INTO THE LABOUR MARKET.”

3. How to prioritize structural reforms?

3.1. Growth effects

There is a great degree of uncertainty regarding the short term and medium term effect of structural reforms. Empirical results are not easy to compare as they use different data and methodology. Still, we can identify three important criteria for evaluating the growth effect of structural reforms: The time horizon (short term, medium term and long term effects), the economic conditions (normal, good or bad times), and sequencing and package deals.

First, it almost goes without saying that reform effects on growth get larger over time. Most reforms have transitional costs in the beginning. For example, simulations show that in the first five years growth rates will be less than two percent higher but after five years they can be higher than two percent.[21] Estimates suggests that after 50 years euro-area GDP will by somewhere between 12 and 17 percent higher, if structural reforms have been implemented, than compared to a baseline scenario.[22]

21. Andersen *et al.* (2014).
22. Andersen *et al.* (2014); J. Varga and J. Veld, "The potential growth impact of structural reforms in the EU – a benchmarking exercise", European Commission: *European Economy, Economic Papers* No 541, December 2014.

Labour market reforms, in particular reforms of the unemployment insurance and employment protection legislation, tend to have small (or even negative effects) in the early years of implementation.[23] By contrast, a reduction of the labour tax wedge and an increase of ALMPs have already a sizeable effect in the short run because they also have a demand-side component.[24] When comparing growth effects in the long run of different reforms when implemented simultaneously,[25] calculations suggest that the largest growth gains can be made with reforms in the non-tradable sector, such as the service sector, with about 4.2 percent deviation in GDP form the baseline, followed by reforms in the tradable sectors (3.0 percent) and tax reforms (1.2 percent). All labour market reforms have an effect smaller than 1 percent. These effects are, of course, depended on a variety of factors. There is, nonetheless, agreement that labour markets and product markets are the two most important reform areas when it comes to growth effects.

Second, reforms have different effects on growth depending on the overall condition of the economy, as the IMF shows:[26] In times of low growth, some structural reforms can have significant negative results. For instance, a revision of unemployment benefits and employment protection legislation can further decrease demand and prolong the recession. It will also affect low-income households disproportionality and may raise inequality.[27] By contrast, structural reforms that have a Keynesian component, such as investing in vocational training and ALMP or reducing the tax wedge can increase wages and thereby help to sustain or increase demand. It has been shown, for instance, that boosting ALMP in particular can increase both equality and efficiency.[28] This means that some structural reforms are better left for good economic times. Product market reforms work well in good and bad economic climate.

Structural reforms have also a budgetary effect: Policies that have a Keynesian component may cost money in the short run, even if the effect on the public budget is neutral or even positive in the long run. Policies such as cutting unemployment benefits or reforming pensions may reduce budgetary pressures[29] but also reinforce the slump. There is a thin line between choosing reforms that do not deepen the recession but also do not strain the public budget. Some reforms can have a neutral effect on the budget and work in good and bad times:[30] tax reforms such as reducing the labour tax wedge and shifting from direct to indirect taxation and product market reforms.

Third, sequencing and package deals are important. Simulations suggest that the growth effect of product market reforms and labour market reforms is larger over time if they are implemented simultaneously because many reforms are complementary.[31] Front-loading may also be politically easier as package deals can be compromises between different political parties and stakeholders. Research suggests further that product market reforms should be implemented prior to labour market reforms because product market reforms increase employment and help to absorb potential losers of labour market reforms.[32] The estimations also show that the effects on growth will be larger for the euro-area periphery countries than for the core.[33]

The empirical evidence in a nutshell: All structural reforms have a positive effect on growth in the medium or long run. This effect gets larger over time. Some reforms have a negative effect in the short run and in particular during a recession. Reforms should be front-loaded but still sequenced: Product market reforms should always be implemented prior to labour market reforms, and labour market reforms with an embedded stimulus should be prioritized. There is no consensus on whether product market reforms or labour market reforms will have larger growth effects in the long run, but there is general agreement that these two areas are the most important ones for structural reforms in the euro area. Countries in the euro-area periphery will reap larger growth benefits from reforms than countries in the geographic core.

23. Andersen *et al.*, (2014).
24. R. Duval and D. Furceri (2016).
25. Andersen *et al.* (2014).
26. R. Duval and D. Furceri (2016).
27. O. Causa *et al.*, "Structural Reforms and Income Distribution", *OECD Economic Policy Paper* No. 13, OECD Publishing, Paris, April 2015.
28. B. Cournède *et al.*, "Effects of Pro-Growth Policies on the Economic Stability of Firms, Workers and Households", OECD Economic Policy Paper No. 12, Paris: OECD Publishing, April 2016.
29. R. Bouis *et al.*, "The short-term effects of structural reforms: an empirical analysis", *OECD Economics Department, Working Papers* No. 949, 2012
30. Combining the findings from IMF (2016) and OECD (2012).
31. Andersen *et al.* (2014); ECB (2015).
32. O. Blanchard and F. Giavazzi, "Macroeconomic Effects of Regulation and Deregulation in Goods and Labour Markets", *Quarterly Journal of Economics* 118(3): 879-907, August 2003.
33. Andersen *et al.* (2014).

3.2. Contribution to euro area stability

In addition to contributing to growth, structural reforms may also help to increase the adjustment capacity of the euro area, as also the ECB has argued.[34] In his view, euro-area countries should focus on product market reforms because they improve the real exchange rate channel and thereby promote cyclical convergence.[35] Here, the most promising reforms are opening up sheltered sectors for competition by facilitating market entry, opening up professional services and integrating the service sector, as well as harmonizing regulations especially in the digital sector[36] and reducing regulatory uncertainty. Thus, completing the European Single Market should be on top of the euro-area reform agenda.

"INSTEAD OF TREATING LABOUR MARKET AND PRODUCT MARKET REFORMS AS EQUALS, THERE SHOULD BE A CLEAR FOCUS ON PRODUCT MARKET REFORMS."

This also shows that the reform recommendations judged by the numbers do not set the right emphasis. Instead of treating labour market and product market reforms as equals, there should be a clear focus on product market reforms. Labour market reforms, financial sector reforms, taxation reforms and public sector reforms are also important but from an economic perspective – both theoretically and empirically – product market reforms are more important.

Recent analyses agree that product market reforms should have priority. This assessment is also shared by the ECB and the IMF. The ECB concluded: "More product market reforms should be considered the highest priority at the current juncture."[37] And the IMF summed up its findings with the key point: "Product market reforms should be implemented forcefully. . . ."[38] The fact that there are by far more labour market reform recommendation than product market ones blurs these clear policy messages.

3.3. Political feasibility

There are very few good economic reasons for delaying structural reforms, as Mario Draghi, the president of the ECB put it in June 2016[39], but many understandable political ones. The political feasibility of structural reforms is indeed disputed. Jean-Claude Juncker, then the Prime Minister of Luxembourg and the President of the Eurogroup, famously said "We all know what to do, but we don't know how to get re-elected once we have done it."[40] The political economy of reforms is at the heart of the problem: there are national and euro-area level considerations as well as the question of whether there is fiscal space for reforms.

First, structural reforms can be politically painful and governments, which implement structural reforms, are less likely to win re-election. It follows that structural reforms should be implemented early into the electoral cycle so that the benefits of reforms already occur during the legislation. In addition, governments should aim for low-hanging fruits, i.e. reforms that offer "quick-wins" in the short run.[41] These reforms may also help to increase the acceptance of more demanding reform packages later.

The empirical evidence, however, also shows that reformist governments are not always punished. The electorate may also reward politicians for necessary reforms and for overcoming a reform backlog.[42] Announcing structural reforms now and implementing them later may work, if the commitment is seen as credible. If

34. P. Praet, "Structural reforms and long-run growth in the euro area", *Intervention at the 43rd Economics Conference of Österreichische Nationalbank*, Vienna, 15 June 2015.
35. Compare A. auf dem Brinke *et al.* (2016).
36. For the Digital Single Market see P.-J. Dittrich, H. Enderlein & D. Rinaldi, "#AmitiéDigital. A Franco-German Axis to Drive Digital Growth and Integration", *Policy Paper*, Jacques Delors Institut – Berlin, forthcoming.
37. European Central Bank, Account of the monetary policy meeting of the Governing Council of the European Central Bank, held in Frankfurt/Main 20-21 April 2016, published 19 May 2016.
38. R. Duval and D. Furceri, "Structural Reforms in Advanced Economies: Pressing Ahead and Doing them Right", *IMF Survey magazine: IMF Research*, 6 April 2016.
39. Mario Draghi, "5th Annual Tommaso Padoa-Schioppa Lecture", *Brussels Economic Forum*, 9 June 2016.
40. *The Economist*, The Quest for Prosperity, 15 March 2007.
41. H. Enderlein and J. Pisani-Ferry, Reforms, Investment and Growth: An agenda for France, Germany and Europe, Report to Sigmar Gabriel (Federal Minister for Economic Affairs and Energy) and Emmanuel Macron (Minister for the Economy, Industry and Digital Affairs), 27 November 2014.
42. M. Buti *et al.*, "Defying the Juncker Curse: Can Reformist Governments Be Re-elected?", *European Commission, Economic Papers* No. 324, May 2008.

financial markets work well and the changes are priced immediately into the market, transitional costs will be smaller and short-lived.

The recent period has shown again that countries are more likely to reform in times of crisis. However, a crisis may become so severe that some structural reforms are not the optimal policy response given their possible short term costs and only medium to long term gains. The reform backlash in Greece and Spain is a case in point and shows that during a severe economic crisis, further reform measures must be implemented with great care. One difficulty in the current situation despite low interest rates and low oil prices is that global demand remains weak and cannot readily offset a fall in domestic demand.

"THE SOCIAL CONSEQUENCES OF REFORMS HAVE OFTEN BEEN AN AFTERTHOUGHT IN THE DEBATE. HOWEVER, THEY SHOULD FEATURE IN THE EQUATION FROM THE BEGINNING."

The social consequences of reforms have often been an afterthought in the debate. However, they should feature in the equation from the beginning. Fighting poverty and inequality in the short-run may take precedence over other reform agendas. Labour market reforms that impose high costs on the losers (if only in the short run) should be avoided during recession. Reforms that lead to wage cuts in the short run, will further reduce demand, may lead to poverty, and could worsen the slump.[43]

Trust in institutions can be an important predictor for reform success. Even reforms that have negative effects in the short run can erode social trust and hinder future reforms. This may lead to a vicious cycle: As citizens lose trust in Europe in the face of rising unemployment rates in some member states, reforms become impossible to implement and the deadlock remains. It follows from this that only structural reforms with a positive short to medium term effect should be implemented when trust is low to prepare the grounds for more far-reaching reforms.

Second, and in addition to national political considerations, euro-area countries must follow the rules of the Stability and Growth Pact (SGP): the deficit-to-GDP ratio may not exceed 3 percent and the debt-to-GDP ratio may not be larger than 60 percent. The SGP does provide for flexibility to allow countries to reform even if that entails deviating from the medium-term objectives.[44] These reforms must be major, have a direct effect on the public budget over the long run, be announced ex-ante and then have to be fully implemented.[45]

Does the SGP constrain or incentivize reform? The empirical evidence is mixed. A comparison of the implementation record[46] for the CSRs of 2014 and 2015 shows that the euro-area member states are not systematically worse in implementing structural reforms.[47] Earlier work, however, finds that non-euro-area countries have been more active when it comes to single market rules implementation.[48] Contrary, other empirical evidence suggest that the euro area has facilitated product market reforms but not labour market reforms in the 2000s.[49] The ECB concluded that labour market reforms have been implemented while product market reforms lag behind.[50] Thus, there seems to be no consistent pattern of whether euro-area membership has contributed or hindered the feasibility of reforms.

What is clear is that if rules worked, the structural reform implementation record would look different. How to incentivize reforms remains a key question. Positive conditionality seems like a promising avenue. Investment may also be coupled to the successful implementation of structural reforms.[51]

43. G. Eggertson, A. Ferrero and A. Raffo, "Can structural reforms help Europe?", *Journal of Monetary Economics* 61, pp. 2-22, 2014.
44. For the legal framework, see Article 5 of Council Regulation No 1466/97 for members states under the preventive arm of the SGP, and Article 2 of Council Regulation No.1467/97 for countries under the corrective arm of the SGP.
45. European Commission, "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact", *Communication* COM(2015), 12 final, Strasbourg, 13 January 2015.
46. Comparing implementation records is methodologically not easy. Consider for instance that endogenous change in the form institutions adapting to a new economic environment without passing legislation, may lead to similar results than newly implemented reforms. More reforms are not necessarily a sign of a well-functioning economy.
47. European Parliament (2016).
48. M. Monti, A New Strategy for the Single Market, Report to the President of the European Commission José Manuel Barroso, 9 May 2010.
49. A. Alesina, S. Ardagna, and V. Galasso, "The Euro and Structural Reforms", *NBER Working Paper Series* No. 14479, November 2008.
50. European Central Bank (2016).
51. See for instance, H. Enderlein *et al.*, Repair and Prepare: Strengthening Europe's Economies After the Crisis, Gütersloh: Jacques Delors Institut – Berlin and Bertelsmann Stiftung, 2014.

Third, there is the question of whether reforms are feasible given the availability of fiscal space. Countries on a sustainable public debt path with no excessive deficit should in principle be able to finance reforms. The most commonly measures are the debt to GDP ratio and the cost of servicing the debt. But judging the availability of fiscal space is not easy. The European Commission so far has been more cautious than the OECD when it comes to the availability of fiscal space. In November 2016, however, it announced that the euro area would benefit from a positive fiscal stance.[52]

> "AS SOON AS THERE IS SOME FISCAL SPACE, REFORMS SHOULD HAVE A DEMAND-SIDE COMPONENT AND AIM AT INCREASING FUTURE GROWTH RATES."

The relation between fiscal space and structural reforms could become a chicken and egg problem: To create fiscal space, one needs to reduce the debt, increase the growth rate and maintain low interest rates. Reducing the debt level entails consolidating fiscal policies, while increasing the growth rates in weak economic climate, which requires investments. Getting the sequencing right will therefore be important: Without fiscal space, reforms should be budget neutral or save money in the medium term. As soon as there is some fiscal space, reforms should have a demand-side component and aim at increasing future growth rates.

The current monetary situation has had a positive and negative effect on fiscal space. On the one hand, the low (and sometimes negative) inflation rates have not helped to reduce the debt burden. On the other hand, quantitative easing by the ECB has led to lower interest rates which have reduced the cost of borrowing, and thereby opened the field for more investment. The verdict is still out on whether quantitative easing will incentivize or disincentives more structural reforms.

The ECB has repeatedly argued that it is already doing all it can to facilitate reforms. In this view, the euro area economies are missing a crucial window of opportunity to implement reforms. Yet at the same time, its monetary stance may also contribute to sustain the current situation and may have prompted member states to postpone difficult reforms.

To sum up the evidence: In terms of political feasibility, reforms should be implemented early in the electoral cycle and there should be package deals. When bundling reforms, policy-maker should pay attention to combining quick-win reforms with reforms that may have transitional costs or take longer to show economic benefits. While it may be easier to implement reforms during an economic boom, there may be more public support for a reform agenda during an economic downturn.

However, during a severe recession, governments should avoid reforms that have large transitional costs and reduce disposable income. Judging whether there is fiscal space for reforms is difficult as it depends not only on the nominal amount of debt, but also growth rate forecasts and interest rate developments. In general, debt levels in the euro area remain high, even in the presence of quantitative easing. Reforms that are budget neutral should be prioritized.

52. European Commission, "Towards a Positive Euro Area Fiscal Stance", EPSC Strategic Note Issue 20, 23 November 2016.

4. Conclusion: The euro area reform priorities on a single page

This paper has tried to bring some clarity into the often confusing discussion about structural reforms. To conclude, we make the attempt to summarise the reform priorities in a single graph. Such a representation might be controversial, but could contribute to making the discussions more straightforward and transparent. We proceed in two steps:

First, we recall the five important **insights on how to identify the right structural reforms**: (A) Reforms with significant transitional costs should be avoided during bad economic times. (B) Most reforms are complementary and joined implementation yields larger effects. (C) Product market reforms should be implemented prior to labour market reforms. (D) If there is fiscal space or in other words, not an unsustainable public debt and deficit, reforms should include a demand-side component. (E) Frontloading and package deals can be politically easier.

Second, on the basis of these rules we identify **three content-based reform priorities:**

1. Product market reforms should be the top priority now. They have the highest short-term gains, can be implemented in good and bad economic times, have the largest effects on potential growth and can contribute significantly to the functioning of the euro area. For the euro area single market reforms are the most rewarding ones. Here, service sector reforms are of key importance because it remains fragmented despite the enormous growth potential: the service sector employs more than 70 percent of the total labour force[53] and produces 74 percent of value added in the euro area.[54] The Service Directive of 2006 was projected to increase GDP in the whole European Union by more than 1 percent of which only additional growth of which only a fraction has been realized so far.[55] Deregulating closed professions and opening up sheltered sectors, as well as supporting the Digital Single Market by reconsidering the country of origin rule and harmonizing regulation of the 28 countries might be good steps in the right directions.

2. Boosting investment to increase the growth potential while providing also an accommodating demand context is a second priority. Investments can but do not necessarily have to be public investments. Countries with fiscal space should directly invest in education, research and investment. Investments here count as reform in the sense that they change the structure of the economy. There are, however, also ways and means to foster investment when public finances are tight: These are measures to reduce regulatory uncertainty and thereby foster long-term investments such as tackling the resolution of non-performing loans and revising bankruptcy procedures. Reducing regulatory uncertainty builds trust in the markets. Completing the single market will also have direct positive effects for private investment as it will increase returns to investments in countries with small and weak demand, if access to the entire single market is guaranteed.

3. Labour market reforms need to continue but with some change in focus because they tend to have transitional costs in the short term, benefits take longer to materialize, some of the reforms do not work well in times of weak economic growth and there are potentially powerful veto players to counter reform efforts. Reforms to harmonize employment protection legislation and integrate outsiders in the labour market should be implemented. If possible, reforms should have a demand-side component to stabilize the economy, such as investment in education, vocational training, ALMPs and life-long learning. Product market reforms can also go a long way in increasing employment and restoring competitiveness.

53. OECD (2016), Structural Analysis Database (STAN).
54. European Central Bank (2016), Structure of the euro area economy: Key characteristics, value added by economic activity, data for 2015.
55. See for instance: J. Monteagudo, A. Rutkowski, and D. Lorenzani, "The economic impact of the Service Directive: A first assessment following implementation", *European Economy: Economic Papers* 456, European Commission, June 2012; E. Fernández Corugedo and E. Pérez Ruiz, "The EU Service Directive: Gains from Further Liberalization", *IMF Working Paper* WP/14/113, July 2014

Table 1 shows how the reform priorities for each euro-area country could be summed up on a single page. As a final take-home message we advocate that not the most frequently mentioned reforms should be implemented, but the ones that fulfil the objectives of increasing growth and improving the functioning of the euro area also in difficult economic times.

TABLE 1 ► The top three reform priorities for euro-area countries

	#1 COMPLETE THE SINGLE MARKET	#2 BOOST INVESTMENT	#3 INCREASE EMPLOYMENT
Belgium Cyprus Finland Greece Ireland Italy Luxembourg	• Increase competition in product market • Open up sheltered sectors • Remove barriers to entry • Move to service sector reforms	• Reduce regulatory uncertainty • Improve resolution of non-performing loans • Improve bankruptcy procedures	• Bring wage growth in line with productivity growth • Take national situation into account • Harmonize EPL • But stabilize demand
France Lithuania Portugal Slovenia Spain	• Increase competition in service sector • Open up sheltered sectors • Deregulate closed professions • Integrate the Digital Single Market	• Reduce regulatory uncertainty • Improve resolution of non-performing loans • Improve bankruptcy procedures	• Reduce dualism by integrating outsiders into the labour market • Harmonize EPL • Increase spending on vocational training, ALMPs, child care, life-long learning
Austria Estonia Germany Latvia Malta Netherlands Slovakia	• Increase competition in service sector • Open up sheltered sectors • Deregulate closed professions • Integrate the Digital Single Market	• Increase public and private investment • Increase public investment in education, research and infrastructure • Encourage public-private partnerships • Improve access to finance also for SMEs	• Reduce dualism by integrating outsiders into the labour market • Enable young, woman, unemployed, under-employed and migrants to increase labour supply • Increase spending on vocational training, ALMPs, child care, life-long learning

APPENDIX

TABLE A1 ► Overview of country reform recommendations

Table shows reform consensus of the key recommendations by the OECD and the European Commission (COM).

COUNTRY	REFORM PRIORITY	OECD	COM	CONSENSUS
Germany	Increase investments in education and research	Yes[1]	Yes[2]	Yes
	Increase investments in infrastructure	Yes	Yes	Yes
	Implement incentives for later retirement	Yes	Yes	Yes
	Increase competition in the service sector	Yes	Yes	Yes
	Integrate refugees and migrants (training and labour market easing)	Yes	No	No
	Deregulate professional services	Yes	Yes	Yes
	Address regulatory biases or privatize in areas such as Landesbanken, car manufacturing, network industries	Yes	No	No
	Integrate women better into the labour market also by lowering secondary earner penalties	Yes	Yes	Yes
	Comprehensive application of environmental/ energy taxes	Yes	No	No
France	Limit spending in government and administration, especially local government	Yes[3]	Yes[4]	Yes
	Ensure wage development in line with productivity gains	No	Yes	No
	Reduce labour tax wedge	Yes	No	No
	Coordinate minimum wage development in accordance with employment objectives	No	Yes	No
	Increase competition in the service sector esp. professional services	Yes	Yes	Yes
	Implement more investment-friendly business regulation	Yes	Yes	Yes
	Simplify and improve tax system, shift to consumption based taxation	Yes	Yes	Yes
	Introduce more efficient environmental tax	Yes	No	No
	Lower taxes on corporate income	No	Yes	No
	Reduce EPL of open-ended contracts, allow for more flexible work hours	Yes	Yes	Yes
	Tie unemployment benefits to activation and adjust benefit duration	Yes	No	No
	Improve vocational training system	Yes	No	No

1. OECD, OECD Economic Surveys: Germany 2016, OECD Publishing, Paris, 2016.
2. European Commission, Country Report Germany 2016, Commission Staff Working Document, SDW(2016) 75 final, February 2016.
3. OECD, OECD Economic Surveys: France 2015, OECD Publishing, Paris, 2015.
4. European Commission, Country Report France 2016, Commission Staff Working Document, SDW(2016) 79 final, February 2016.

COUNTRY	REFORM PRIORITY	OECD	COM	CONSENSUS
Italy	Limit spending in government and administration	Yes[5]	Yes[6]	Yes
	Improve tax compliance, simplify tax system	Yes	Yes	Yes
	Improve infrastructure	No	Yes	No
	Reform public administration and civil justice system	No	Yes	No
	Reform corporate governance rules of banks	No	Yes	No
	Address non-performing loans problem / improve insolvency procedures	Yes	Yes	Yes
	ALMP	Yes	Yes	Yes
	Simplify labour contracts	Yes	Yes	Yes
	Increase female participation in the labour market (better care infrastructure)	Yes	No	No
	Tie unemployment benefits to activation	Yes	No	No
	Effective framework for collective bargaining	No	Yes	Yes
	Allow for plant level wage bargaining	Yes	No	No
	Enhance competition in public and private sector (local public services, banking, network, regulated professions, retail)	Yes	Yes	Yes
Spain	Restructure and privatize savings banks	Yes[7]	Yes[8]	Yes
	Improve cost-effectiveness in healthcare sector	No	Yes	No
	Ensure wage development in line with productivity gains	No	Yes	No
	Increase competition in the service sector, professional services	Yes	Yes	Yes
	Remove business regulation barriers for large firms	No	Yes	No
	Shift from labour to consumption, environment and real estate taxes	Yes	No	No
	Broaden corporate tax base, eliminate special regimes for SMEs	Yes	No	No
	Improve insolvency procedures	Yes	No	No
	Improve ALMP, employment agency	Yes	No	No
	Improve vocational training system	Yes	No	No
	Strengthen innovation and research, e.g. in universities	Yes	No	No
Belgium	Limit spending in government and administration	Yes[9]	Yes[10]	Yes
	Ensure wage development in line with productivity gains	Yes	Yes	Yes
	Broaden tax base and lower tax rates	Yes	Yes	Yes
	Shift from labour tax to consumption, environment and real estate taxes	Yes	Yes	Yes
	Raise retirement age	Yes	Yes	Yes
	Improve education and labour market integration for disadvantaged groups including migrants	Yes	Yes	Yes
	Reduce financial disincentives to work	No	Yes	No
	Promote more efficient and equitable housing, make better use of housing in urban areas, improve social housing	Yes	No	No

5. OECD, OECD Economic Surveys: Italy 2015, OECD Publishing, Paris, 2015.
6. European Commission, Country Report Italy 2016, Commission Staff Working Document, SDW(2016) 81 final, February 2016.
7. OECD, OECD Economic Surveys: Spain 2014, OECD Publishing, Paris, 2014.
8. European Commission, Country Report Spain 2016, Commission Staff Working Document, SDW(2016) 78 final, February 2016.
9. OECD, OECD Economic Surveys: Belgium 2015, OECD Publishing, Paris, 2015.
10. European Commission, Country Report Belgium 2016, Commission Staff Working Document, SDW(2016) 71 final, February 2016.

COUNTRY	REFORM PRIORITY	OECD	COM	CONSENSUS
Austria	Curb expectations of government guarantees in the banking sector, implement resolution directive	Yes[11]	No[12]	No
	Address vulnerabilities of financial sector in foreign exposure and insufficient asset quality	No	Yes	No
	Make regional governments more cost-efficient	Yes	No	No
	Shift from labour tax to consumption, environment and real estate taxes	Yes	Yes	Yes
	Increase effective retirement age	Yes	No	No
	Increase labour market participation of elderly	No	Yes	No
	Foster more competition in services, lower entry barriers	Yes	Yes	Yes
	Improve education and labour market integration for disadvantaged groups including migrants	Yes	No	No
	Increase female participation in the labour market by improving child care and abolishing tax disincentives	Yes	Yes	Yes
	More family friendly work places in the public sector	Yes	No	No
Ireland	Broaden tax base by shifting taxes to immovable assets, reducing allowances for capital income, and aligning corporate tax system	Yes[13]	Yes[14]	Yes
	Improve cost-effectiveness of healthcare system	Yes	Yes	Yes
	Accelerate resolution of non-performing loans via court system	Yes	Yes	Yes
	Improve responsiveness of housing supply, avoid home buyer subsidies	Yes	No	No
	Strengthen monitoring by the Central Bank of Ireland, make central credit registry operational	No	Yes	No
	Set up more agile, relevant and gender-inclusive vocational training scheme	Yes	No	No
	Provide support to disadvantaged schools	Yes	No	No
	Improve ALMP by reforming employment services, better training for long-term unemployed	Yes	No	No
	Increase incentives to work including withdrawal of benefits, enforce obligations for unemployed	Yes	Yes	Yes
	Improve access to quality child care, esp. for low-income groups	Yes	Yes	Yes
Netherlands	Strengthen tax base, reduce mortgage interest relief and phase-out lower VAT rate	Yes[15]	Yes[16]	Yes
	Revise tax incentive and ensure social security coverage for self-employed	Yes	No	No
	Reduce contributions to pension scheme in the early years of working life	No	Yes	No
	Ease regulation on private supply of rental housing	Yes	Yes	Yes
	Improve access to social housing		Yes	No
	Foster investment in renewable energy	Yes	No	No
	Increase public support for R&D	Yes	Yes	Yes
	Enhance credit access for SMEs, foster competition of credit provision, consider credit register for companies	Yes	No	No
	Improve education and labour market integration for disadvantaged groups	Yes	No	No
	Raise quality of early childhood education	Yes	No	No
	Foster general skills in vocational training	Yes	No	No
	Enhance entrepreneurial skills of small companies	Yes	No	No
	Ease EPL to facilitate prevalence of permanent contracts	Yes	No	No

11. OECD, OECD Economic Surveys: Austria 2015, OECD Publishing, Paris, 2015.
12. European Commission, Country Report Austria 2016, Commission Staff Working Document, SDW(2016) 88 final, February 2016.
13. OECD, OECD Economic Surveys: Ireland 2015, OECD Publishing, Paris, 2015.
14. European Commission, Country Report Ireland 2016, Commission Staff Working Document, SDW(2016) 77 final, February 2016.
15. OECD, "OECD Economic Surveys: Netherlands 2016", OECD Publishing, Paris, 2016.
16. European Commission, Country Report Netherlands 2016, Commission Staff Working Document, SDW(2016) 87 final, February 2016.

COUNTRY	REFORM PRIORITY	OECD	COM	CONSENSUS
Portugal	Improve public service efficiency, reduce number of civil servants	Yes[17]	No[18]	No
	Increase transparency of PPPs at local and regional level	No	Yes	No
	Improve resilience of financial sector, esp. timely and consistent recognition of losses, develop stress test framework, and provisional capital requirements	Yes	No	No
	Address corporate debt overhang and efficiency of debt restructuring	No	Yes	No
	Enhance competition in the non-tradable sector, e.g electricity	Yes	No	No
	Promote wage-bargaining at firm level	Yes	No	No
	Align wages and productivity taking into account wide disparity of productivity	No	Yes	No
	Strengthen R&D by improving links between researchers and private sector, tax credits for R&D	Yes	No	No
	Better targeting of social safety net, raise benefit levels of minimum income support	Yes	Yes	Yes
	Make unemployment benefits independent of age and widen coverage	Yes	Yes	Yes
	Scale-up ALMP	Yes	Yes	Yes
	Scale-up adult education and training	Yes	No	No
	Improve medium-term sustainability of pension scheme	No	Yes	No
	Safeguard financial sustainability of state-owned enterprises	No	Yes	No
	Improve tax compliance and efficiency of tax administration	No	Yes	No
Finland	Curb public expenditure growth	Yes[19]	Yes[20]	Yes
	Open retail sector, transport and construction for effective competition	Yes	Yes	Yes
	Improve work incentives, reduce and shorten duration of unemployment benefits, enforce mandatory job search	Yes	No	No
	Limit use of early exit pathways to retirement	Yes	Yes	Yes
	Shift from (low-income) labour taxes to consumption, environment and real estate taxes	Yes	No	No
	Improve R&D cooperation between businesses and universities	Yes	No	No
	Encourage female labour market participation by reducing duration of parental leave and home-care allowance	Yes	No	No
	Strengthen mediating role of the state in wage-setting process on local level	Yes	No	No
	Strengthen vocational training and development of job relevant skills of young people, old workers and long-term unemployed	Yes	Yes	Yes
	Increase productivity and cost-effectiveness in the provision of public services, including municipal structure, healthcare and social services	No	Yes	No

17. OECD, OECD Economic Surveys: Portugal 2014, OECD Publishing, Paris, 2016.
18. European Commission, Country Report Portugal 2016, Commission Staff Working Document, SDW(2016) 90 final, February 2016.
19. OECD, OECD Economic Surveys: Finland 2016, OECD Publishing, Paris, 2016.
20. European Commission, Country Report Finland 2016, Commission Staff Working Document, SDW(2016) 94 final, February 2016.

COUNTRY	REFORM PRIORITY	OECD	COM	CONSENSUS
Greece	Enhance administrative capacity	Yes[21]	Yes[22]	Yes
	Strengthen public financial management and public procurement	No	Yes	No
	Broaden tax base and strengthen tax administration through more autonomy and more resources	Yes	Yes	Yes
	Strengthen tax compliance and fight tax evasion	No	Yes	No
	Improve bankruptcy framework, improve resolution of non-performing loans	Yes	Yes	Yes
	Strengthen governance and independence of state intervention of banks	No	Yes	No
	Create fiscal space for more comprehensive social safety net and ALMP	Yes	No	No
	Fight poverty by guaranteeing minimum income, school meal program, and housing assistance	Yes	Yes	Yes
	Fight undeclared work	No	Yes	No
	Modernize public employment service	Yes	Yes	Yes
	Strengthen vocational training	No	Yes	No
	Conclude pension reform, also review special regimes and introduce basic pension	Yes	Yes	Yes
	Ease regulation in network industries	Yes	Yes	Yes
	Reduce rigidities in product markets	No	Yes	No
	Reduce backload of cases in the judiciary system	Yes	No	No
	Improve cost-effectiveness of healthcare system	No	Yes	No
Cyprus	Stabilize, restructure and recapitalize the banking sector	NA[23]	Yes[24]	Yes[25]
	Step up supervision of financial services and strengthen anti-money laundering framework	NA	Yes	Yes
	Broaden tax base for indirect and direct taxes	NA	Yes	Yes
	Cut wages of public sector employees	NA	Yes	Yes
	Improve targeting of social transfers by tightening means-tested criteria	NA	Yes	Yes
	Raise retirement age and limit use of early retirement	NA	Yes	Yes
	Raise efficiency of healthcare system	NA	Yes	Yes
	Improve cost-effectiveness of public administration	NA	Yes	Yes
	Privatize SOEs	NA	Yes	Yes
	Lift entry barriers and operation restrictions in service sector	NA	Yes	Yes
	Improve functioning of housing market, also reduce backlog of title deeds	NA	Yes	Yes
	Diversify energy mix	NA	Yes	Yes

21. OECD, OECD Economic Surveys: Greece 2016, OECD Publishing, Paris, 2016.
22. Key deliverables from the 2015 Memorandum of Understanding (MoU). Please note that Greece has not received CSRs because it is under a stability support programme. The MoU recommendations are more detailed. Here they have been consolidated to allow for a comparison to the other reform recommendations.
23. The OECD does not cover Cyprus in its Economic Surveys Series or any comparable recommendation format.
24. European Commission, The Economic Adjustment Programme for Cyprus, Occasional Papers 149, Brussels, 2013.
25. Cyprus is only covered in detail by the MoU but because it is a country under programme, all reforms are here ranked as consensus reforms.

COUNTRY	REFORM PRIORITY	OECD	COM	CONSENSUS
Estonia	Improve labour market participation by implementing Work Ability reform	No	Yes[26]	No
	Raise incentives to work through measures targeting low-income earners and narrow gender pay gap	Yes[27]	Yes	Yes
	Improve vocational training scheme	Yes	Yes	Yes
	Improve framework for R&D	Yes	Yes	Yes
	Expand access to European transport and energy networks	Yes	No	No
	Strengthen insolvency procedures	Yes	No	No
	Raise revenues from property taxes	Yes	No	No
	Reduce costs borne by workers of compulsory private pension scheme, reduce exceptions in public pension scheme	Yes	No	No
	Prioritize spending on ALMP, infrastructure and education	Yes	No	No
Latvia	Improve vocational training	Yes[28]	Yes[29]	Yes
	Increase offers for work-based learning	Yes	Yes	Yes
	Concentrate public support for research and innovation on limited number of specialization areas	No	Yes	No
	Reduce high tax wedge for low-income earners and shift taxes to sources less detrimental for growth	Yes	Yes	Yes
	Increase employability of unemployed	No	Yes	No
	Ensure targeting of social assistance benefits	Yes	Yes	Yes
	Improve cost-effectiveness and accessibility of healthcare system	No	Yes	No
	Improve efficiency of the judicial system	No	Yes	No
	Improve public service legislation to strengthen conflict of interest legislation	No	Yes	No
	Reduce entry-barriers, red tape and simplify licensing in product markets	Yes	No	No
	Improve governance of SOEs	Yes	No	No
	Improve connection of energy network with EU	Yes	No	No
	Improve tax compliance and tackle tax fraud	Yes	No	No
	Improve resilience of financial sector and strengthen monitoring	Yes	No	No

26. European Commission, Country Report Estonia 2016, Commission Staff Working Document, SDW(2016) 76 final, February 2016.
27. OECD, OECD Economic Surveys: Estonia 2015, OECD Publishing, Paris, 2015.
28. OECD, OECD Economic Surveys: Latvia 2015, OECD Publishing, Paris, 2015.
29. European Commission, Country Report Latvia 2016, Commission Staff Working Document, SDW(2016) 82 final, February 2016.

COUNTRY	REFORM PRIORITY	OECD	COM	CONSENSUS
Lithuania	Broaden the tax base	Yes[30]	Yes[31]	Yes
	Improve tax compliance and fight tax evasion	Yes	Yes	Yes
	Improve labour market relevance of education	Yes	Yes	Yes
	Improve performance of healthcare system	Yes	Yes	Yes
	Reduce high tax wedge for low-income earners and shift taxes to sources less detrimental for growth including environment and property tax	Yes	Yes	Yes
	Improve pension adequacy	No	Yes	No
	Improve coverage and adequacy of unemployment insurance	Yes	Yes	Yes
	Strengthen ALMP to increase employability of unemployed, and improve capacity of employment agency	Yes	Yes	Yes
	Promote life-long learning	Yes	No	No
	Increase the role of workplace training	Yes	No	No
	Make teaching profession more attractive through higher wages and investment in teacher development	Yes	No	No
	Promote participation in pre-primary education	Yes	No	No
	Strengthen innovation of domestic firms	Yes	No	No
Luxembourg	Broaden tax base to consumption, property tax and environment tax	No	Yes[32]	No
	Limit early retirement and increase retirement age	No	Yes	No
	Reform wage-setting system to ensure wages evolve with productivity	No	Yes	No
	Strengthen financial service monitoring	Yes[33]	No	No
	Strengthen resolution procedures, undertake resolvability assessments of banks	Yes	No	No
	Improve effectiveness of R&D spending	Yes	No	No
	Improve quality of school education	Yes	No	No
	Promote environmentally friendly policies including public transport and petrol taxes	Yes	No	No
	Introduce spending review mechanism and consider introducing a spending ceiling	Yes	No	No
Malta	Improve education system, also reduce early school leaving, promote attainment of basic skills	No[34]	Yes[35]	No
	Increase statutory retirement age	No	Yes	No
	Improve credit access for businesses including small and micro-enterprises	No	Yes	No

30. OECD, OECD Economic Surveys: Lithuania 2016, OECD Publishing, Paris, 2016.
31. European Commission, Country Report Lithuania 2016, Commission Staff Working Document, SDW(2016) 83 final, February 2016.
32. European Commission, Country Report Luxembourg 2016, Commission Staff Working Document, SDW(2016) 84 final, February 2016.
33. OECD, OECD Economic Surveys: Luxembourg 2015, OECD Publishing, Paris, 2015.
34. The OECD does not cover Malta in its Economic Survey Series or any comparable recommendation format.
35. European Commission, Country Report Malta 2016, Commission Staff Working Document, SDW(2016) 86 final, February 2016.

COUNTRY	REFORM PRIORITY	OECD	COM	CONSENSUS
Slovakia	Improve cost-effectiveness of the healthcare sector	No	Yes[36]	No
	Improve tax compliance	Yes[37]	Yes	Yes
	Improve ALMP, education and training to tackle long-term unemployment	Yes	Yes	Yes
	Develop vocational training system	Yes	No	No
	Strengthen female employment through care provision	Yes	Yes	Yes
	Improve education system by making teaching as profession more attractive and provide better training	No	Yes	No
	Increase participation of Roma children in education and child care	Yes	Yes	Yes
	Invest in infrastructure, improve administrative procedures for permits, and transport network including rail and road	Yes	Yes	Yes
	Improve public procurement, also increase competition in public tenders	Yes	Yes	Yes
	Implement spending ceilings to reinforce budgetary discipline	Yes	No	No
	Strengthen public administration capacity including co-ordination, human resource management, management of EU funds, capacity of local governments	Yes	No	No
	Reduce regulation in professional services & retail trade	Yes	No	No
	Improve efficiency of judicial system	Yes	No	No
	Create incentives for innovation spending	Yes	No	No
	Develop rental housing market and limit support to house owners	Yes	No	No
	Make sure minimum wage implementation does not damage employment	Yes	No	No
Slovenia	Improve wage-setting system also for minimum wage	No	Yes[38]	No
	Address long-term unemployment by increasing employability of low-skilled	Yes[39]	Yes	Yes
	Limit incentives for early retirement and increase retirement age	Yes	Yes	Yes
	Tackle non-performing loan problems in the banking sector and facilitate swift restructuring and resolution of companies	Yes	Yes	Yes
	Improve risk monitoring in banks	No	Yes	No
	Improve access to credit for SMEs	No	Yes	No
	Improve efficiency in judicial system	No	Yes	No
	Increase cost-efficiency in education, public administration and local government	Yes	No	No
	Privatize SOEs	Yes	No	No
	Adopt credible fiscal rules (supervised by financial council)	Yes	No	No
	Increase efficiency in the health sector	Yes	No	No
	Ease licensing for opening new businesses	Yes	No	No
	Support innovation, promote collaboration between major stakeholders in innovation policy	Yes	No	No

36. European Commission, Country Report Slovakia 2016, Commission Staff Working Document, SDW(2016) 93 final, February 2016.
37. OECD, OECD Economic Surveys: Slovakia 2014, OECD Publishing, Paris, 2014.
38. European Commission, Country Report Slovenia 2016, Commission Staff Working Document, SDW(2016) 92 final, February 2016.
39. OECD, OECD Economic Surveys: Slovenia 2015, OECD Publishing, Paris, 2015.

TABLE A2 ► Overview of euro area reform recommendations

Table shows reform consensus of the key recommendations by the OECD and European Commission's (EC) country-specific recommendations (CSRs).

REFORM PRIORITY	OECD	COM	CONSENSUS
Reform employment protection legislation	No	Yes[40]	
Increase active labour market policies	No	Yes	
Promote lifelong learning strategies and increase adult skill level	No	Yes	
Offer adequate income support during labour market transition	No	Yes	
Strengthen single market for services and deregulate professional services	No	Yes	
Reducing high tax wedge and shift to consumption or environment taxes	No	Yes	
Create investment-friendly business regulation	No	Yes	
Reduce public administration inefficiencies	No	Yes	
Improve access to finance for SMEs, esp. via capital markets	No	Yes	
Improve job market relevance of education and training, and cooperation with stakeholders	No	Yes	
Speed up and facilitate resolution of NPLs where they create serious economic disturbances, also by raising capital surcharges	Yes[41]	No	
Establish asset management companies at EU level	Yes	No	
Reduce risk in the banking sector	Yes	No	
Implement a European Deposit Insurance Scheme	Yes	No	
Harmonize banking resolution in Europe	Yes	No	
Finance higher-risk projects through EFSI	Yes	No	
Increase targeted public support to investment	Yes	No	
Enhance framework conditions for private investment	Yes	No	
Adopt national expenditure rules	Yes	No	
Ensure that the application of the debt reduction rule of the Stability and Growth Pact does neither hinder recovery nor structural reforms	Yes	No	

40. European Commission, Report on the Euro Area, Commission Staff Working Document, SWD(2015) 700 final, November 2015.
41. OECD, OECD Economic Surveys: Euro Area 2016, OECD Publishing, Paris, 2016.

TABLE A3 ► Reform priorities by countries

Overview of all consensus reforms based on table A1.

	PRODUCT MARKET	FINANCIAL SECTOR	LABOUR MARKET	TAXATION	PUBLIC SECTOR
Austria	Foster more competition in services, lower entry barriers	None	Increase female participation in the labour market by improving child care and abolishing tax disincentives	Shift from labour tax to consumption, environment and real estate taxes	None
Belgium	None	None	Ensure wage development in line with productivity Raise retirement age Improve education and labour market integration for disadvantaged groups including migrants	Broaden tax base and lower tax rates Shift from labour tax to consumption, environment and real estate tax	Limit spending in government and administration
Cyprus	Privatize SOEs Lift entry barriers and operation restrictions in service sector	Stabilize, restructure and recapitalize the banking sector Step up supervision of financial services and strengthen anti-money laundering framework	Raise retirement age and limit use of early retirement	Broaden tax base for indirect and direct taxes	Cut wages of public sector employees Improve targeting of social transfers by tightening means-tested criteria Raise efficiency of healthcare system Improve cost-effectiveness of public administration Improve functioning of housing market, also reduce backlog of title deeds Diversify energy mix
Estonia	None	Raise incentives to work through measures targeting low-income earners and narrow gender pay gap Improve vocational training scheme	None	None	Improve framework for R&D
Finland	Open retail sector, transport and construction for effective competition	None	Limit use of early exit pathways to retirement Strengthen vocational training and development of job relevant skills of young people, old workers and long-term unemployed	None	Curb public expenditure growth
France	Increase competition in the service sector Implement more investment-friendly business regulation	None	Reduce EPL of open-ended contracts, allow for more flexible work hours	Simplify and improve tax system, shift to consumption tax	Limit spending in government and administration

	PRODUCT MARKET	FINANCIAL SECTOR	LABOUR MARKET	TAXATION	PUBLIC SECTOR
Germany	Increase competition in the service sector Deregulate professional services	None	Integrate women better into the labour market Implement incentives for later retirement	None	Increase investment in education Increase investment in infrastructure and research
Greece	Ease regulation in network industries	Improve bankruptcy framework, improve resolution of non-performing loans	Conclude pension reform, also review special regimes and introduce basic pension	Broaden tax base and strengthen tax administration through more autonomy and more resources	Enhance administrative capacity Fight poverty by guaranteeing minimum income, school meal program, and housing assistance Modernize public employment service
Ireland	None	Accelerate resolution of non-performing loans via court system	Increase incentives to work including withdrawal of benefits, enforce obligations for unemployed	Broaden tax base by shifting taxes to immovable assets, reducing allowances for capital income, and aligning corporate tax system)	Improve cost-effectiveness of healthcare system Improve access to quality child care, esp. for low-income groups
Italy	Enhance competition in public and private sector	Address non-performing loans problem, improve insolvency procedures	Increase ALMP Simplify labour contracts Install effective framework for collective bargaining	Improve tax compliance and simplify tax system	Limit spending in government and administration
Latvia	None	None	Improve vocational training Increase offers for work-based learning	Reduce high tax wedge for low-income earners and shift taxes to sources less detrimental for growth	Ensure targeting of social assistance benefits
Lithuania	None	None	Improve labour market relevance of education Improve coverage and adequacy of unemployment insurance Strengthen ALMP to increase employability of unemployed, and improve capacity of employment agency	Broaden the tax base Improve tax compliance and fight tax evasion Reduce high tax wedge for low-income earners and shift taxes to sources less detrimental for growth including environment and property tax	Improve performance of healthcare system
Luxembourg	None	None	None	None	None
Malta	None	None	None	None	None
Netherlands	None	None	None	Strengthen tax base, reduce mortgage interest relief and phase-out lower VAT rate	Ease regulation on private supply of rental housing Increase public support for R&D
Portugal	None	None	Make unemployment benefits independent of age and widen coverage Scale-up ALMP	None	Better targeting of social safety net, raise benefit levels of minimum income support

	PRODUCT MARKET	FINANCIAL SECTOR	LABOUR MARKET	TAXATION	PUBLIC SECTOR
Slovakia			Improve ALMP, education and training to tackle long-term unemployment Strengthen female employment through care provision	Improve tax compliance	Increase participation of Roma children in education and child care Invest in infrastructure, improve administrative procedures for permits, and transport network including rail and road Improve public procurement, also increase competition in public tenders
Slovenia		Tackle non-performing loan problems in the banking sector and facilitate swift restructuring and resolution of companies	Address long-term unemployment by increasing employability of low-skilled Limit incentives for early retirement and increase retirement age		
Spain	Increase competition in the service sector, professional services	Restructure and privatize private banks	None	None	None

Source: Based on the reform recommendations by the OECD and European Commission (as cited above also in the appendix), compiled by authors.

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