Economic Policy

Question
How successful has economic policy been in providing a reliable economic framework and in fostering international competitiveness?

41 OECD and EU countries are sorted according to their performance on a scale from 10 (best) to 1 (lowest). This scale is tied to four qualitative evaluation levels.

10-9 = Economic policy fully succeeds in providing a coherent set-up of different institutional spheres and regimes, thus stabilizing the economic environment. It largely contributes to the objectives of fostering a country’s competitive capabilities and attractiveness as an economic location.

8-6 = Economic policy largely provides a reliable economic environment and supports the objectives of fostering a country’s competitive capabilities and attractiveness as an economic location.

5-3 = Economic policy somewhat contributes to providing a reliable economic environment and helps to a certain degree in fostering a country’s competitive capabilities and attractiveness as an economic location.

2-1 = Economic policy mainly acts in discretionary ways essentially destabilizing the economic environment. There is little coordination in the set-up of economic policy institutions. Economic policy generally fails in fostering a country’s competitive capabilities and attractiveness as an economic location.

Denmark

Prior to the global financial crisis, the Danish economy experienced a boom period. Unemployment reached record lows, there was a current account surplus and the public budget was in the black. However, there were also clear signs of an overheating economy driven by booming domestic demand. The housing market experienced very strong price increases, in part driven by financial liberalizations and the so-called tax freeze, which put a limit on property taxation (ejendomsværdiskatten). The high employment rate resulted in wage increases, and since productivity growth fell below competitors’ levels, wage competitiveness deteriorated significantly over the period up to the financial crisis. Structural problems were growing, but the country’s favorable account balance concealed the problems.

The global financial crisis significantly affected the Danish economy. GDP decreased by about 1% in 2008 and by 5.7% in 2009. Although average growth has been positive since 2009, the growth rate has been modest and thus insufficient to produce an employment increase. Growth forecasts for 2013, by both the government and the Economic Council, predict a growth rate below 0.5%, and a growth rate close to 1.5% in 2014. Hence, the recovery is expected to come slowly. Registered unemployment has more
than doubled (gross unemployment has increased from 2% to about 6%), but this conceals a much larger drop in employment. Roughly, the decrease in employment is twice the increase in unemployment. The difference is explained by a significant drop in the labor force, which is due to large inflows into education, increase in activation, as well as to the number of recipients of social assistance not ready for work. Moreover, there may be some hidden unemployment since the registered unemployment rate only includes the unemployed entitled to benefits or social assistance. Unemployment insurance is voluntary, implying that some unemployed are not eligible for unemployment benefits, and at the same time a shortening of the benefit period (from four to two years) has been a major issue since expiring unemployment benefits may imply loss of income support since social assistance is means tested on a family basis. Various ad-hoc measures have been taken to minimize the consequences of this “drop out problem.”

Public finances changed from large surpluses to deficits as a consequence of the crisis. The large change was a consequence of the sharp decline in GDP and the rather strong automatic budget response (automatic stabilizers). As a consequence, Denmark was violating the 3% budget norm outlined in the Stability and Growth Pact, and it accordingly has entering the excessive deficit procedure. The EU recommendation was that Denmark, over the period 2010 to 2013, should bring the deficit below the 3% norm and improve the structural budget by 1.5 percentage points relative to GDP.

The policy agenda (regeringsgrundlag) of the new Social Democratic-Social Liberal-Socialist People’s Party government that came to power in October 2011 put high priority on kick-starting the economy by strengthening competitiveness and reforming the tax code to reduce tax on earned income. Economic parameters have also affected other reforms adopted under the new government, including reforms of social assistance and study grants. These reforms aim at getting unemployed to look for jobs and students to get through their studies faster. In April 2013, a growth pact was adopted with broad support in the Parliament.

Citation:
Estonia

Score 9

As an EU member state, Estonia forms its economic policy in accordance with EU strategies. Thus, the ideology of smart growth has been the guiding principle of national economic policy. Estonia used to have seven-year-strategies for entrepreneurship policies; the strategy one for the period 2014 – 2020 was in process at the time of writing. Elaboration of economic and innovation policy is the responsibility of the Ministry of Economic Affairs and Communications. In parallel, the Ministry of Education and Research develops and coordinates developments of R&D strategies.

These two strategies are supposed to be complementary. However, poor coordination, duplication and lack of synergy between ministries have been continuous problems. A clear example of lacking coordination is the issue of labor policy. The Ministry of Economic Affairs analyses the current and perspective need for labor, Ministry of Education implements initial and in-service training policy, and the Ministry of Social Affairs is responsible for employment policy. Additionally, since there is a lack of highly qualified workers, the Ministry of Interior, which is responsible for immigration issues, also becomes an important actor in economic policy. Besides a lack of coordination between ministries, a shortage of qualified and motivated workers is another barrier in building a smart economy.

As for good performing areas in Estonia’s economic policy, the advancement of international business activities is one. Government strongly supports enterprises in enhancing their export capacities, mainly via Enterprise Estonia, which provides financial assistance, counseling, cooperation opportunities and training for entrepreneurs. In 2009 – 2012 exports more than doubled and contributed substantially to the recovery of the national economy following the economic downturn.

Norway

Score 9

Norway’s public finances are solid, the state budget effectively running a massive and durable surplus as a result of vast petroleum revenues from the North Sea as well as healthy budgetary discipline. The country has long enjoyed strong economic growth and near-full employment, and has benefited from a well-functioning system of tripartite cooperation. The country weathered the recent world economic crisis with only modest adverse effects. Petroleum revenues are managed in a way that is seen internationally as exemplary, as they are used domestically with prudence and otherwise invested internationally through a sovereign fund focused on
equity, bonds and property assets. The Norwegian krone is strong, and gained further strength during the recent international financial turmoil.

The state wields exceptionally strong influence within the economy. About 40% of the equity on the Oslo stock exchange is under state ownership. Combined with the additional 30% under foreign ownership, this means the remaining indigenous private-capital sector is relatively small. When the state makes its investments, it most often does so on market terms. Economic policy is generally considered to be fair and transparent. Regulatory arrangements are generally seen to be sound, although the Oslo stock exchange is volatile, and has been plagued by rumors of insider trading.

The primary strength of Norway’s economy lies in the public sector, particularly with respect to employment. The strongest areas are petroleum and petroleum-related industries such as maritime activities, as well as fisheries and fish-farming. It is a high-cost economy, both in terms of wages and taxes, and international competitiveness suffers in industries outside the petroleum sector.

Although the country has managed its petroleum wealth responsibly, the economy is strongly petroleum-dependent and entrenched at a high cost level. Some observers are concerned that a lack of competitiveness in the mainland economy might pose a future challenge to maintaining the country’s high standard of living and to expectations for continued high public-service standards. The downside of a petroleum-dominated economy, critics argue, is an economy that lacks entrepreneurship, is weak in terms of conventional industries, and has less long-term strength than might be suggested by current favorable indicators.

**Sweden**

The international financial press has painted a good picture of Sweden’s economic policy and development in Sweden during the last couple of years, and for good reason. Overall, the Swedish economy fared comparatively well during the global financial crisis, and Swedish crisis management seems to have been extraordinarily successful.

Sweden has recently received numerous accolades for its financial management. The Financial Times named Finance Minister Anders Borg “Best Finance Minister in Europe,” and The Economist has urged the rest of the world to look at the “New Nordic Model” as a leading example of economic policy. International institutions like the OECD and European Union have likewise praised the Swedish trajectory of economic development and the role of government in securing that development.
Along with Australia, Sweden is the only country that currently has a budget surplus goal written into the economic policy regulatory framework. Mainly for technical reasons, the goal was recently reduced from 2% to 1%. There is now a debate about whether the goal prevents government from implementing a more dynamic and efficient economic policy, or if it provides stability and firm control over revenues and expenditures.

The government has implemented a series of reforms that have provided long-term stability in the economy. Also, and equally important, the current government has chosen not to alter regulatory frameworks which might jeopardize stability, for instance labor market regulations.

Most economic indicators on Sweden look good. This is particularly the case with international competitiveness. However, inflation is comparatively high, especially given the low interest rate, and unemployment is also comparatively high, at least higher than could be expected from the hitherto Swedish full employment in Europe.

Moreover, some sectors of the economy, for example the housing market, suffer from low efficiency and lack of transparency. In addition, the tax reforms the government implemented in the period under review further undermined economic equality. Still, the Swedish economy and Swedish regulation of the economy may be judged as highly competitive and efficient. Whether this record is due to policy incentives, or if it is a consequence of Sweden being not a member of the eurozone, is contested in economic literature.

Citation:
The Economist (February 2-8, 2013), "The next supermodel: Why the world should look at the Nordic countries"


Switzerland

Score 9

The Swiss economic policy regime combines a variety elements It is a very liberal and depoliticized regime with regard to the regulation of the labor market, in particular to hiring and firing. The rules in this area are very close to those of the United States. By contrast, it was in the past a very liberal and politicized regime with regard to the in- and outflow of foreign labor. The country's economic policy regime is based on the integration of employers and trade unions into the policymaking process, with employers having the
largest amount of influence ("liberal corporatism") and trade unions serving as junior partners. For trade unions, this corporatism has made sense, since it resulted in a regime of full employment (at least for Swiss citizens), high wages and generous private social policy implemented on the firm level. In addition, public-sector social policy has been expanded in terms of programs and expenditure levels.

Throughout the 20th century, Switzerland maintained a very protectionist policy regime, allowing for cartels and the exclusion of competition. The main beneficiaries were farmers, who were protected from world market competition by high tariffs, as well as small and medium-sized businesses and service providers producing for the domestic market. In addition to high tariffs and strict non-tariff barriers to foreign competitors, business was protected through the acceptance of high tariffs from abroad. Furthermore, collusive pricing was tolerated, while competition between providers and producers was limited by the variance in cantonal regulations. This latter aspect made it very difficult for businesses to make competitive offers and win bids outside their home cantons. However, this protectionism has changed considerably since the mid-2000s, replaced by a liberalization trend that continued during the 2011 – 2013 period. Economists have attributed the Swiss economy’s strong growth since about 2005 to this liberalization. Today, it is an economy open to the world market, with domestic rules that facilitate the internationally competitive nature of large enterprises such as chemical producers and banks.

The government levies low taxes on both labor and capital, producing relatively small tax wedges. In return, this liberal state does not make significant interventions into the business cycle. Rather, it used to pursue a prudent and basically pro-cyclical fiscal policy. In times of major economic problems, such as in 2008 and 2009, fiscal stimulation packages have been implemented. However, for institutional and political reasons, these packages have typically been very limited in size. In addition, it proved difficult to implement these packages swiftly. In fact, many of the resources contained in these fiscal programs have not been taken up by employers.

The country’s policymakers have long placed particular emphasis on a prudent fiscal policy (maintaining low levels of deficit and debt) and price stability. Prudent fiscal policy has resulted from a combination of institutional factors, in particular the fiscal weakness of the federal state compared to the cantons, rules limiting excessive deficits and debts (for example, a so-called debt brake), and the effects of direct democracy. Citizens have typically been reluctant to accept any policy changes implying an increase in taxation. These institutional factors have been further reinforced by the distribution of political power, in particular by the weakness of the political left, and the presence of a strong party (the Free Democrats, which are in this respect
liberal) that supports a constrained-tax state. Responsibility for price stability is left to the independent National Bank, which is tasked with maintaining price stability as a primary goal, and has the tools of monetary and interest rate policy at its disposal.

In general, decision-makers have pursued a very pragmatic and heterodox economic policy, and have shown themselves willing to disregard liberal norms of policymaking if the need arises. For example, in recent years the Swiss government and the Swiss National Bank intervened massively to prevent the bankruptcies of Swiss International Air Lines, the national airline, and UBS, one of the country’s two major banks.

This policy regime, which has been both liberal and protectionist, has come under pressure due to various changes in the economic environment. For one, deindustrialization and a marked shift to a service economy has meant a change in the demand for labor. The industrial sector once offered a large number of jobs with low skill requirements. These jobs were staffed to a disproportional extent by foreign labor. Due to the rules of the work permit system, many foreign workers gained access to unlimited work permits between the mid-1970s and the mid-1990s. However, given their low skill levels, there is not enough demand for these employees in the modern high-skill service sector. Hence, the unemployment curve has shifted upward, and is today characterized by high rates of unemployment among foreign workers with low skills.

At the same time, employers are recruiting increasingly highly skilled labor for the service sector. It is true that Switzerland has depended on the inflow of highly skilled employees for the last century, but this process has further intensified during the last 20 years. One result has been a pronounced increase in social tension. Historically, the highly educated Swiss middle classes have been very much in favor of a pro-foreigner policy, as long as these foreigners did not offer major competition for this social sector’s jobs and housing opportunities. With the increasing inflow of highly skilled German labor, this tolerance has eroded. For example, significant populist opposition to the hire of professors from Germany at the universities of Zurich and Berne in the past three years was led both by right- and left-wing politicians. In the spring of 2013, politicians on both the left and right took (primarily symbolic) action to reduce the inflow of labor from the European Union, seeking to appease citizens who fear the increasing competition of (highly qualified) foreign individuals for jobs and housing, as well as in the use of infrastructure such as railways. Hence, one of the pillars of Switzerland’s economic success will arguably be politically less sustainable than in the past. One recent example was provided by the invocation of a safety-valve clause in the country’s bilateral agreements with the European Union on labor mobility. This allowed for a temporary restriction on labor
inflow from the EU if a certain threshold had been passed. This measure makes little sense in economic terms, and entails some political costs in dealing with the European Union; however, it represents one response to ordinary citizens’ unease over the increasing share of foreigners.

Globalization has also led to the increasing importance of international organizations such as the WTO. Given its reliance on sectors such as chemicals and machine production, banking and tourism, Switzerland has had no option but to accept the liberalization of trade and services. Otherwise, retaliation by other nations would be economically extremely expensive. However, this has implied that sectors once strongly shielded by protectionist policies have become liberalized. Agriculture offers a major case in point. As a result of this liberalization from outside, the previous complementarily between protected domestic industries and a world-market-oriented industry – the driver of Switzerland’s post-war economic successes – has become strained. The potential increase in tensions between the export and domestic sectors has not resulted in open conflict, with the exception of some minor actions at the beginning of the period of liberalization. Yet these developments have increasingly undermined the country’s system of interest representation and the corporatist structure of interest intermediation. Interest organizations, in particular employers’ groups, have lost support, while their members have increasingly engaged in individual lobbying.

On a related note, Switzerland has not yet solved the question of its long-term relationship with the European Union. Provisional solutions have entailed bilateral agreements between the European Union and Switzerland, which have had major implications for the further liberalization of the service and agriculture sectors. In addition, immigration policy has changed substantially. Switzerland has abstained from any further recruitment of foreign labor from non-EU countries (for which there is little demand anyway), and has liberalized the immigration regime with EU countries. Essentially, this has meant free movement of labor between Switzerland and the European Union, intensifying the new problems and cleavages associated with the recruitment of highly skilled employees from abroad. However, this bilateral strategy today faces major problems. The European Union has requested institutional solutions to replace the bilateral relationship, arguing that the implementation and update of bilateral agreements has become too costly in terms of time and internal conflict. Specifically, the EU has requested the creation of independent institutions for settlement of disputes on the basis of the bilateral agreements, and as well as mechanisms for updating bilateral agreements without having to resort to new full-scale negotiations. As of the spring of 2013, neither the European Union nor the Swiss government had shown themselves willing to make substantial compromises on these issues. This calls the future relationship
between Switzerland and the EU into question. Given the country’s close integration with the EU market – 60% of Swiss exports go to the European Union, and 80% of its imports come from the EU – Switzerland is highly dependent on a functional working relationship with this much larger economic partner. By contrast, the EU is much less dependent on Switzerland.

Switzerland was a laggard in the development of the welfare state, though it caught up in the post-war period. Today it has a mature and generous liberal-conservative welfare state. In times of demographic change, this welfare state is only sustainable through high rates of economic growth. However, the protectionist elements of the country’s economic policy regime inhibit growth to some extent. As a result of various liberalization measures, Switzerland’s rate of economic growth has arguably increased considerably during the past eight years. However, it is far from clear whether these growth rates are sufficient to sustain the generous welfare state given future demographic developments.

Canada

Score 8

Canada has implemented market-oriented economic policies that have enhanced the country’s competitiveness and attractiveness as a location to do business. Yet these policies appear not to have had a positive impact on productivity growth, which has been very weak. There are still areas where Canada’s economic framework is not as conducive as it might be to productivity growth. The most egregious of these is the continued presence of marketing boards, which have the right to control output through production quotas. Interprovincial barriers to trade and labor mobility, and the lack of a national securities regulator are other weaknesses in Canada’s regulatory framework from a competitiveness perspective. Overall, the federal government has recognized the interplay between different regimes with regard to the aims of economic policy, as seen in the Economic Action Plan, as the federal budget released in March 2013 is called.

Citation:

Chile

Score 8

Chile has an advanced macroeconomic and financial policy regime in place. This is rules-based and combines a floating exchange rate, inflation targeting, an overall government budget rule, and effective regulation and
supervision of banks and capital markets. As a result, macroeconomic performance has generally been quite satisfactory. A dominant economic role is assigned to markets and the private sector, complemented by active government regulation and policies aimed at limiting noncompetitive market conditions, extending social protection, and reducing poverty and income concentration. Economic legislation and regulations provide a level playing field for domestic and foreign competitors. Barriers to international trade and capital flows are negligible, and international competitiveness, adjusted for labor productivity, is relatively high. These policies have enabled a relatively high level of growth, and poverty rates have fallen substantially in the last few decades. During the last two years, economic growth has again increased and unemployment slightly decreased.

On the other hand, major structural weaknesses can be observed. Low labor efficiency represents an increasing problem. This is especially the case in small- and middle-scale businesses which are the largest source of employment and labor in Chile. The highly bureaucratic public administration is another negative aspect that limits productivity. Moreover, economic stability and growth almost completely depend on the export of commodities such as copper and agri- and silvicultural products with relatively low added value. In the long run, deficiencies in the education system, and low investment rates in infrastructure and R&D will probably hinder economic growth and sustainable development.

Finland

Score 8

The Finnish economy has not recovered in full from a recession in 2008 – 2009, and GDP levels still remain somewhat below 2008 levels. In fact, the impact of the recession on public finances has been so strong that a full recovery is envisioned a few years still into the future. Fiscal policy is a concern, considering growing public debt and government spending that is more than 50% of GDP. To restore fiscal sustainability, the government’s 2013 budget aims for greater prudence and balance. The government is also seeking to raise the minimum statutory retirement age, to improve incentives for older people to continue working, and is working to reform the system of wages setting. So far efforts have been mixed. However, without significant reforms of the retirement system, significant further fiscal consolidation will soon be needed to manage the increasing costs of Finland’s aging population.

According to the Heritage Foundation 2013 Index of Economic Freedom, Finland’s economy was ranked 16 among the freest economies, showing improvements in the management of public finances, investment and labor freedoms. In the European region, Finland ranked seventh out of 43
countries. During the period, the government has maintained monetary stability well and encouraged entrepreneurship. Finland remains open to international trade and investment, as its investment regulations are transparent and efficient.

Citation:

Germany

Score 8

Over the last 10 years, Germany’s economic policy has successfully addressed numerous serious economic weaknesses prevalent in the post-unification period. A wave of reforms (affecting labor-market institutions, unemployment benefits, the pension system, company taxation, the constitutional debt brake, and the liberalization of labor migration from outside the EU, among others) has improved Germany’s competitiveness and increased its attractiveness as an destination for cross-border investment. Moreover, trade unions and employers’ associations have eschewed ideology in setting wage policy, allowing for significant firm-level flexibility. Over the last decade, unit labor costs have remained largely stable, in contrast to significant increases in many other European countries. Only recently has the buoyant labor market led to trends of rising wages, along with a slight increase in unit labor costs. The new strength of the Germany economy was demonstrated impressively through its robust performance coming out of the 2009 recession and since the outbreak of the euro-area debt crisis. This economic performance provides a favorable contrast with other European countries.

Employment rates have risen continuously, while unemployment rates, after a modest increase in 2008 and a brief period of stagnation in 2009, have been in decline. The negative growth of the 2009 recession was quickly compensated for through high subsequent growth rates. In a comparative perspective, Germany’s economic structure is characterized by a healthy mix of service and industrial sectors (cf. Statistische Bundesamt). Productivity has increased at a rate considerably higher than the EU average for the past three years.

Germany’s ability to refinance its debt on international capital markets has never been better. Furthermore, the inward flow of foreign direct investment has increased considerably. According to the United Nations Conference on Trade and Development (UNCTAD), Germany has received the sixth-largest absolute total of foreign direct investment worldwide (with a stock of inward foreign direct investment amounting to a total of $713 billion by the end of 2011).
On the other hand, despite the considerable progress made in recent years, a number of concerns remain. For instance, a dual labor market has emerged, as has a population of working poor, due to the increase in less-regulated temporary work with low wages. The number of sectors with minimum wages has increased in recent years, and all political parties have given serious consideration to the introduction of general minimum wages. Separately, the tax system still creates labor-market disincentives for second earners in a family.

In spite of these imperfections, Germany’s economic policy over the last 10 years has clearly been successful in making the German economy a highly efficient location that global investors today perceive as an economic safe haven.

**Latvia**

Score 8

After securing an emergency assistance package from the IMF, the European Union and others, and following a difficult adjustment program, Latvia has rebounded from economic crisis, returned to the international markets, and set itself again on a path of growth. Its economy grew by 6.9% in 2012, one of the highest such rates in Europe.

Economic policy has been governed by parameters laid out in the assistance programs. The difficult adjustment program provided Latvia with a framework for creating sustainable fiscal discipline. The Latvian government has been successful in implementing the policies outlined in these programs, and is on track for accession to the euro in 2014. The convergence report and the EU decision on Latvia’s entry into the euro zone was expected in mid-2013. Latvia repaid all outstanding loans to the IMF in 2012, three years ahead of schedule.

Unemployment rates have been falling, from 16.2% in 2011 to 14.9% in 2012, and showing a continuing downward trend in 2013 (as indicated by the Central Statistical Bureau). However, structural unemployment remains a challenge.

The government has focused strongly on meeting euro accession criteria. Nevertheless, structural reforms are also ongoing in the areas of education and science, the energy market, and the judicial system, among others. The government’s commitment to and ability to implement these reforms appears weaker than in the case of the euro-related policies. Significant parliamentary and stakeholder resistance has emerged, stalling higher-education reform, and delaying the opening of the energy market to competition, for example.
Lithuania’s economic policies have created a reliable economic environment, fostering the country’s competitive capabilities and improving its attractiveness as an economic location. In 2013, the World Bank ranked Lithuania 27th worldwide in terms of ease of doing business. The individual attributes of registering property (5th place), enforcing contracts (14th place), trading across borders (24th place), resolving insolvency (40th), dealing with construction permits (48th place), getting credit (53th place), paying taxes (60th place), and protecting investors (70th place) were rated above the Eastern Europe and Central Asia regional average (73rd place), whereas those of getting electricity (75th place) and starting a business (107th place) fell below that average. It was ranked 45th in the World Economic Forum’s 2012 – 2013 Global Competitiveness Report, with some factors such as higher education and training ranked 26th worldwide) scoring above its overall average, and some factors such as financial-market development (87th place worldwide) falling significantly below.

In a 2012 assessment, the European Commission identified the following challenges to Lithuania’s long-term competitiveness: unfavorable demographic developments, labor market deficiencies and high emigration rates, growing levels of poverty and social exclusion, a lack of competition and interconnections in the country’s infrastructure (particularly its energy system), low energy efficiency (especially in the case of buildings), a low level of R&D spending, and poor performance with respect to innovation. Lithuanian authorities have sought to address these concerns through the national reform and convergence programs, as well as through other reform measures, with only mixed success.

Although the 2008 – 2012 Lithuanian government stabilized Lithuania’s economy and public finances through substantial fiscal consolidation, other reform efforts have been more limited, in particular those relating to the labor market, social policies, energy efficiency and the energy sector.
Considerable political emphasis has been placed on structural reforms, especially in the previous government’s program, but a significant number of these have been left unimplemented. Although the economic crisis of 2008 – 2009 provided a window of opportunity to reform inefficient sectors, no consistent reform program was undertaken. As the economy recovered, in recent years becoming one of the fastest-growing economies in the European Union, the political will to reform has decreased, especially in fields such as the pension system or health care. Streamlining the regulatory environment for businesses is one of the few areas where progress has been achieved.

Citation:
Also, see the Doing Business Report and the Global Competitiveness Report.

Malta

Score 8

Economic planning is at the forefront of Malta’s policymaking prowess, and a clear-cut assignment of tasks to government institutions is its strength. There are important ties between public institutions as well as between the economic planning ministry and social partners. The government retains final decision-making powers; however, consultation with social partners through the Malta Council for Economic and Social Development occurs regularly, in which council, budgetary, labor and fiscal policies are agreed upon. Because of these strong ties, Malta managed to weather the global economic crisis better than most other EU member states. This is corroborated by the European Economic Forecast, which highlights the fact that Malta’s labor market is resilient and boasts one of the lowest unemployment rates in the euro area.

Furthermore, economic diversification, supported by a solid banking system, ensured fewer repercussions during the crisis. Financial services, pharmaceuticals, online gaming, aviation maintenance, tourism, information and communication technology, high value-added manufacturing and the maritime sector have all contributed to economic growth, even during the European recession. Since EU membership in 2004, Malta has also strengthened its regulatory institutions, entrenching efficient anti-monopoly policies, while membership in the euro zone has forced it to further expand its economic planning capacity.

A 2012 World Bank Report reviewing the ease of doing business ranked Malta 167th worldwide, citing long delays in obtaining construction permits and electricity services. Local businesses also cited the high cost of
electricity in eroding their competitive edge. A heavy reliance on construction and falling property prices also signals a need for further economic diversification. In the 2012 Global Competitiveness Index, Malta ranked high (15th) in financial market development, though it lagged behind in labor market efficiency and market size. Due to its small size and limited resources, the country is in a better situation to serve specialized niches rather than cater for the mass market.

Co-determination within individual enterprises is however non-existent.

Citation:
European Economic Forecast Winter 2013 p.66
Pre-Budget Document 2013, p. 1
vision2015.gov.mt
Global Competitiveness Report 2011- 2012
Sansone, K. Its not Easy Doing Business in Malta Says World Bank. Times of Malta 27/10/12

Netherlands

Score 8

Economic policy shows an intriguing paradox. On the one hand, the overall state of the economy is unambiguously negative: for the first time since 2009, the real economy decreased in 2012; consumption of households (furniture, cars) and business investments (especially in construction) also decreased; inflation increased to 2.9% by the end of 2012. This was partially offset by a growth of external trade. Unemployment increased more than predicted; only in the care sector was there some gain in employment. Austerity measures by the government are imitated by households that spend less and less money on consumption, but, for instance, increase the amount they pay off on mortgages and other debts.

On the other hand, the comparative international situation of the Dutch economy looks excellent. In terms of GDP per capita in 2012, the Netherlands ranks 2nd of the eurozone countries (after Luxemburg) despite the decrease in household spending. In the OECD’s corrected Foreign Direct Investment Restrictiveness Index for 2010, the Netherlands ranks 2nd behind only Luxemburg. In the World Economic Forum’s Global Competitiveness Report the Netherlands increased its ranking from 9th in 2009 to 5th in 2012, due to an improved innovation climate, better education and health, regulatory burden reduction for foreign business and more patents.

This ambivalent situation is generally interpreted thus: the Netherlands is caught in a temporary slump, but prospects for recovery are bright. The opposite interpretation is that, in spite of doing “all the right things” prescribed in the neoliberal economic cookbook, the time for old-fashioned economic growth and recovery is over.
Poland

Score 8

With real GDP growth falling from 4.5% in 2011 to less than 2% in 2012, the effects of the euro crisis arrived in Poland in 2012. The Tusk government reacted to the growing nervousness of international financial markets and weakening external demand with a combination of fiscal adjustments and structural reforms. These moves succeeded in maintaining the confidence of the bond markets without pushing the economy into recession through excessive fiscal tightening. At the same time, the government launched massive structural reforms, such as an increase in the retirement age and a far-reaching deregulation of professions. Since then, however, the reform zeal of the government has weakened. Future perspectives are clouded by concerns about the country’s medium-term fiscal situation. The Tusk government has also failed to develop a clear strategy toward the introduction of the euro.

Austria

Score 7

The Austrian economy remains one of most reliable in Europe. A significant part of that success is still due to the social partners, which are responsible for negotiating institutional and other reforms, and which thus ensure a comparatively peaceful and cooperative relationship between the country’s various economic players. A substantial part of Austrian economic policy is prepared by the social partners. As in other EU countries, however, an ever-more-significant portion of economic policy falls under the European Union’s jurisdiction, thereby creating an increasingly harmonized European economic framework.

The Austrian export industry has contributed significantly to the country’s overall success. Austria’s economy has profited from the inclusion of former communist East-Central Europe into the European single market. However, Austria’s financial sector in particular suffered significant losses in Eastern Europe during the financial crisis due to its substantial exposure to these markets. The Austrian finance (banks, insurance) and construction industries play an important role in the four Visegrad countries and in most of the former Yugoslav republics.
A process of fiscal consolidation is currently under way, with the goal of keeping the government deficit below 3% of GDP. Other programs include a restructuring of the Austrian banking system to reduce the risk it poses to the national economy. Future burdens may rise from the ever-more-significant redistribution of resources to the generation of people 50 years old and above, a trend that clouds the outlook for the young generation and the future of Austria’s economy more generally.

Austria’s rise to become one of the most prosperous countries in Europe, a development with its roots in the early 1950s, is still reflected in its comparatively high rankings in terms of per capita income and employment. However, the country fares less well on rankings of inequality and equality of opportunity; according to a study done by the European Central Bank and published in April 2013, private property in Austria is distributed in an extremely unequal way. The richest 5% of the households in Austria own 37.2% of the overall property in Austria, while the top 50% own 94% of the country’s property. Among the members of the eurozone, only Germany has a more unequal distribution of property.

This seems to contradict the traditional view of Austria as having one of Europe’s most stable social-welfare systems. But these data underline the fact that the Austrian economic success story is not one of increasing equality; indeed, just the opposite is true.

Belgium

Score 7

During the review period, Belgium has enacted many institutional and economic reforms. The prevailing concern that the country may split in two, between Flanders and Wallonia, at some point in the future, partially prevents the government from pursuing effective long-term planning. Yet recent economic and political crises have forced the issue, resulting in a series of necessary decisions that in the end have left the country in a better position than it was two to three years ago.

Political tension has been quelled by officially splitting electoral districts between Flanders and Wallonia that were previously unclearly drawn. The government also managed to cobble together structural reforms of the labor market to ensure better long-run sustainability. Much of the political tension in the country stems from financial transfers from the more affluent region of Flanders to Wallonia. In response to this, the government imposed tough reforms that seek a drastic reduction in such transfers within 10 years, which increases the incentives in Wallonia to seek out forward-looking reforms. And finally, some fiscal competences will be devolved from the center to regional governments, which may trigger some fiscal competition. The issue is
however that fiscal competition risks being intensified in areas that create lots of externalities, making a competitive solution a priori inefficient.

The challenges ahead are enormous: public debt during the review period returned to 100% of GDP, tax rates on labor are the highest in the OECD, and there are pockets of extreme unemployment, in Wallonia and in the Brussels capital region.

Iceland

Iceland’s economic policy during the period under review continued to be dominated by the aftereffects of the financial crisis and economic collapse. The International Monetary Fund (IMF) supported Iceland’s recovery from the crash through a stand-by arrangement involving a short-term IMF loan to Iceland of over $2 billion between September 2008 and August 2011. This loan made possible another similar loan of nearly $3 billion from the Nordic countries, for a total package of about $5 billion. This program, along with the support of the Nordic countries, formed the backbone of Iceland’s economic reconstruction program. The program combined stringent temporary capital controls to prevent the króna from depreciating further with continued monetary restraint and fiscal adjustment equivalent to about 10% of GDP during the 2010 – 2015 period. As implemented, this took the form solely of public expenditure cuts, in the sense that the ratio of general tax revenue is now about the same as it was before the crash. The promised gradual relaxation of the capital controls has been delayed.

In 2008, the IMF forecast that economic growth would resume two years or so after the crash. However, recovery has taken much longer. Economic output fell by 4.1% in 2010, recovering to rise by 2.9% in 2011, and slowing again to 1.6% in 2012. The threat of a new bout of inflation continues to hang over the economy, as a premature or disorderly relaxation of capital controls would most likely cause the currency to depreciate sharply, forcing prices to rise again.

Following the collapse, the government sought to strengthen the Financial Supervisory Authority (Fjármálaeftirlitið, FSA), whose failure to effectively supervise the banks in the years before the collapse was heavily criticized. The number of FSA personnel was increased from 63 in 2008 to 93 in 2010, and further to 117 in 2012. More significantly, a new director was appointed in 2009, who unlike his predecessor, had no party affiliation and went about his supervisory role in a manner that resulted in some 80 cases being referred from the FSA to the Special Prosecutor’s Office. However, this post-crash director came under fierce attack by some of those whom he had a legal obligation to supervise, a conflict that ended in the director’s dismissal.
in 2012. Furthermore, he was cited by a court for having accessed a bank document in an illegal fashion.

The activities of the Icelandic Competition Authority also expanded after the collapse. According to this body's 2012 annual report, the number of pending cases increased by 60% between 2008 and 2011.

The future of banking in Iceland remains uncertain, as the government had not as of the time of writing detailed plans for restructuring and reorganizing the banking system. At the close of the review period, the government owned a majority stake in one of the three large banks that were reestablished on the ruins of the failed banks. Foreign venture funds owned significant stakes in the other two banks, a situation that cannot be expected to last.

Iceland applied for EU membership in 2009. The government in power during the 2009 – 2013 period thus signaled its intention to abide by European standards and discipline and to strengthen Iceland’s institutional environment, including in the area of regulatory policy. However, due to disagreements between the coalition partners, the application process was put on hold in January 2013. After the parliamentary elections in April 2013, the new government decided against pursuing the EU accession negotiations further. The question of whether to continue the negotiations may be put to a national referendum in 2014.

Citation:

Israel

Score 7

The Israeli economy was affected by the aftereffects of the world economic and financial crisis. However, it achieved a growth rate of more than 3% in 2010, higher than that of most industrialized countries. In 2012, economic growth slowed to 3.1%, the inflation rate was 1.6%, the current account was close to balanced, the unemployment rate remained stable at its lowest level in the past 30 years, and the government deficit widened to 4.2% of GDP.

A policy paper issued by the Taub Center in 2012 differentiates between structural and cyclical/temporary economic difficulties in Israel in order to examine the economy’s efficiency outside the influence of short-term disturbances. This enables a review Israel’s overall policy pattern instead of looking at short-term solutions to external or geopolitical pressures. Overall, Israel dealt well with the 2008 – 2009 global crisis and the various related
economic challenges. However, it does show structural problems with respect to core issues such as government spending, housing, health and education, among others. These issues were among the main subjects of middle-class concerns during the demonstration of 2011 – 2012, and were also key issues in the 2013 elections.

A 2011 report prepared by Israel’s central bank identified financial-market centralization, with a concomitant amplification of risk, as one of Israel’s primary problems. This issue has also been identified by the government, which has reduced the amount of risk that banks are allowed to take on for large borrowers. It also established a special committee to investigate options for increasing market competitiveness. This committee published its recommendations in 2012, which were approved by the government shortly afterward. However, these reforms have not been in effect long enough to accurately evaluate their consequences.

Like many countries engaging in privatization, Israel is adapting by expanding its regulatory structures. However, both the IDI and the Van Leer Institute have recently published papers criticizing the underdevelopment of the country’s regulatory framework. For example, research on water and power services shows an unorganized and inefficient regulatory system that is full conflicts of interests. Media, political and public debate are focusing on these issues to various extents.

In general, while Israel’s economic policy has shortcomings, it largely does provide for a reliable economic environment and supports the objectives of fostering the country’s competitive capabilities and preserving attractiveness as a location for economic activity.

Citation:
Bank of Israel report 2011: chapter 4 (Hebrew)
Czamanski, Dany and Maria Marinov, “Economic regulation on water and electricity in Israel,” Van Leer Institute 2011 (Hebrew)
Dryshpitz, Shurik, “Regulation: What, when and where? A theoretical and comparative perspective” IDC, 2010 (Hebrew)
“OECD Economic Surveys: Israel 2011”
The committee for increased competitiveness in the market, “Final recommendations and intermediate report’s supplementaries,” 2012 (Hebrew)

Luxembourg

Luxembourg has been for some time ranked highly on international competitiveness indices, but during the review period its position has slipped. The International Institute for Management Development’s (IMD) index from
position 11 (2011) to 13 (2013). The country’s scored positively on policy stability and predictability, a competitive tax regime, a skilled labor force, a predictable legal framework and a business-friendly environment. Yet the automatic information exchange on capital income will be implemented in January 2015 and is expected to impact the financial sector, which provides a third of Luxembourg’s GDP. The European Union is also in the process of modifying the VAT regime for electronic commerce to the detriment of Luxembourg, which is home to many e-commerce companies because of its favorable tax rates. This will lead to a loss of tax revenue, oblige the government to increase its general VAT rates. New hubs and clusters have been created in an effort to add new revenue sources as the financial sector’s power diminishes. The Luxembourg Cluster Initiative covers priority sectors for the Luxembourg economy: life sciences, eco-technology, information and communication technology, materials and production technologies, space technology, logistics and maritime activities.

To grow, Luxembourg needs to increase its labor force with highly skilled workers. According to employers’ organizations, the government needs to focus policy on accelerating administrative work and procedures as well as tackling the country’s excessive inflation rate through the abolishing of the automatic salary index mechanism, which raises wages automatically according to inflation rates. This would also help the unemployed get back to work as well as encourage other reforms of the education system and of pensions.

The country’s generous welfare model has to be reformed to adapt to a reality of more modest public resources and budgets. While the European Commission in its evaluation of Luxembourg’s Stability Program 2012 – 2015 agreed with this macroeconomic scenario, it highlighted concerns over the country’s overly optimistic economic growth outlook and its inability to address early retirement and pension reform, not to mention for more in terms of the limited application of the country’s salary index mechanism.

Citation:
Observatoire de la compétitivité: économie de la connaissance: http://www.odc.public.lu/indicateurs/tableau_de_bord/index.html
http://www.luxinnovation.lu/Services/Luxembourg-Cluster-Initiative
http://www.wort.lu/de/view/luxemburger-haben-das-hoechste-verfuegbare-einkommen-51bef8afe4b0088ebdef2e24
South Korea

According to OECD data, South Korea showed one of the OECD group’s strongest recoveries from the 2008 global recession, laying the foundation for solid subsequent growth even if cuts are made in government spending. A major strategic change under the Lee administration has been the fostering of innovation in the “green economy.” The government is supporting innovations in fields it considers green, such as river restoration, solar energy, LED lighting, electric vehicles and nuclear power. Lee’s economic policies can be described as business-friendly, with a focus on large companies and economic stimulus through construction projects. The government has also stimulated exports by allowing a dramatic devaluation of the Korean currency against the dollar, totaling almost 40% between early 2008 and early 2009. Since 2009 the Korean currency has steadily and slowly appreciated, but still remained below the pre-crisis level in early 2013.

The government maintained an expansionary economic policy stance in the run up to the important election year of 2012. With respect to macroeconomic policy, inflation became a concern amid increasing consumer prices. In 2011, consumer price inflation rose to 4% despite a government change in the method used to calculate inflation (with the old method inflation would have been 4.4%). Despite inflation concerns there are no attempts to tighten monetary and fiscal policies. Instead the government chose a corporatist strategy by attempting to persuade big companies to lower their prices. The government has also done little to arrest real-estate speculation or high real-estate prices, both of which remain sources of substantial concern in Korea. The focus on an export-oriented and construction-driven recovery remains risky. This strategy makes Korea vulnerable to protectionist backlashes, and prevents an adjustment of the country’s oversized construction sector. To counter these threats, the Korean government has signed trade agreements with the European Union and the United States that came into effect in 2011 and 2012.

During the 2012 presidential campaign, enterprise policies were very important and both candidates favored “Economic Democratization.” It still remains unclear what President Park Geun-hye will actually do. It appears that her definition of democratic democratization largely refers to the fair treatment of SMEs by large business conglomerates.

Citations:
“Gov’t struggling to find anti-inflation steps that stick”, The Korea Times, Jan 10, 2012
United Kingdom

The UK economic framework was substantially reformed after 1979 in a market friendly direction and most of these reforms were maintained after the election of the Labour government in 1997, albeit with some rebalancing towards labor interests – notably through the introduction of a minimum wage. The UK economy grew steadily from the early 1990s up to 2007, but hindsight suggests that the underlying economic model depended too much on consumer demand and on an increasingly risk-prone financial sector. An independent central bank and a golden rule for public finances were supposed to establish macroeconomic stability, but proved to be too easy for the government to manipulate. The resulting high degree of deindustrialization and low level of manufacturing output led to a strong emphasis on the financial sector which contributed substantially both to government revenues, employment, and the country’s balance of payments.

Because of the financial sector’s increased share in the economy, the United Kingdom was badly hit by the financial crisis that began in 2007 and has since been struggling to deal with the aftermath. Taxes on the banking and consumer sectors fell, public expenditure rose and public finances also had to support vulnerable banks.

The change in government in 2010 led to the adoption of an economic policy framework ostensibly focused on budgetary consolidation, but in reality the squeeze on public spending has been less than is often claimed because the government chose to exempt key areas such as health spending. The corollary, especially as the government debt rose, adding to debt service charges, was that cuts in other areas of public spending had to be very deep, and were therefore politically highly contested. The government has so far refused all calls to adjust its strategy, even though the outcomes both in terms of growth, unemployment and budgetary consolidation have not been in line with its expectations – an outcome it blames on headwinds from the euro crisis.

United States

Over the long term, the United States has maintained economic policies that have effectively promoted international competitiveness and economic growth. Compared with other developed democracies, the United States has had low taxes, less regulation, lower levels of unionization, and greater
openness to foreign trade. Although these policies have had costs with respect to social conditions, the country has enjoyed superior growth, capital formation, and competitiveness over the past two decades.

Obama’s economic policy was shaped by the 2008 financial and economic crisis. The Obama administration continued President George W. Bush’s expansionary fiscal policy to stimulate the economy. Some economists criticized the stimulus package as too small, but at least the U.S. economy is recovering. By the third quarter of 2009, GDP growth turned positive again and, in March 2010, job losses stopped. Congressional Republicans and some moderate Democrats have strongly and effectively opposed further stimulation. To prevent a similar crisis in the future, Obama initiated several regulatory reforms. In July 2010, for example, the Dodd-Frank Wall Street Reform Act, designed to improve regulations of eight areas that led to the financial crisis, became law. Additionally, the Consumer Financial Protection Agency improved regulations of credit cards and mortgages. Furthermore, health care reform was partly implemented to control the costs and reduce the federal deficit.

From a long-term standpoint, the U.S. government has been unable to implement a combination of spending cuts (especially reforms of the middle-class entitlement programs, Medicare and Social Security) and tax increases that would produce declining budget deficits and stabilization of the federal debt over a 10 year period. In the context of the ongoing polarization in Congress, Democrats and Republicans have been unable to agree on an appropriate policy to reduce the federal deficit, as the negotiations surrounding the “fiscal cliff” and the resulting sequester have demonstrated. The long-term debt picture has serious implications for monetary stability, and it reduces business confidence. In 2011, for the first time, U.S. treasury bonds lost their historic AAA rating from the rating agency Standard & Poor’s, although the bond market appeared to ignore the change.

Bulgaria

Bulgarian economic policy has been characterized by a discrepancy between macro- and microeconomic policy. The country’s macroeconomic policies are generally effective. The monetary regime – a currency board arrangement tied to the euro – is sound and enjoys a very high level of trust. Tax rates are low and tax bases broad. The fiscal stance of the country is excellent, with low and controlled deficits and a very low level of public debt. By contrast, microeconomic policies in Bulgaria are less successful. Investors complain about regulation and red tape; in many sectors of the economy competition is limited; labor market policy creates disincentives to work and to create jobs; and the Bulgarian government, with its emphasis on creating a low-tax and
low-wage economy, has done little to increase the level of skills, to foster innovation and to raise productivity.

Japan

Score 6

Following the 2009 election, it was hoped that the DPJ-led government could bring a fresh dynamism to economic reform, finding a new sustainable framework to meet the country’s economic and social challenges. However, the split parliament and instability in the political system made it difficult to pass significant reforms. In its public statements, the DPJ government showed that it was aware of the issues at stake. The demand-oriented approach of the government’s New Growth Strategy (based on a June 2010 Cabinet decision), as well as the Ministry of Economy, Trade and Industry’s (METI) September 2011 review of post-Fukushima issues in its Challenges and Actions in Economic/Industrial Policies report, expressed a DPJ political agenda that put new emphasis on social concerns. However, these policies failed to produce significant new economic momentum.

The new LDP-led government, which took office in December 2012, won power promising a so-called three-arrows strategy, consisting of unprecedentedly aggressive monetary easing, a highly ambitious deficit-financed spending program despite the record levels of public debt, and a program of structural reforms. The first two arrows have led to a surge of optimism in the economy, although their unorthodoxy entails grave hazards that would have been deemed irresponsible even a year previously. Moreover, the strong devaluation of the yen in response to the monetary easing has led to serious problems for competing economies, and raises the threat of a global currency war. The eventual implementation of structural reforms (the third arrow) – for instance, targeting the labor market or insolvency procedures – is a necessary but not sufficient condition for the first two arrows to have longer-term positive effects. The government hopes that catalytic policies such as strengthening the role of women in the labor market, dramatically improving English-language competency, and entering negotiations for a Trans-Pacific Partnership (TPP) with the United States will create systemic pressure leading to the necessary structural change.

Mexico

Score 6

On the positive side, the general quality of macroeconomic management in Mexico is good. The Finance Ministry and the central bank benefit from a considerable wealth of technical expertise. Such economic stability in recent years represents a real achievement given the frequency with which Mexico
faced economic crises in the 1980s and 1990s. As a result, the Mexican economy has been able to keep growing despite the recent global economic downturn and current financial difficulties. Microeconomically, the picture is less clear though it has some positive features. Mexico is an export economy tied to the North American market. Its economy can cope for the most part with competition from China, which a few years ago seemed to pose a real threat. Indeed, exports are by and large doing well. However, Mexico has economic problems based on a lack of internal economic competition in key sectors such as telecommunications, with a tendency to generate oligarchies. However, the current Mexican government has made it a priority to increase domestic competition.

Unfortunately, organized crime and the related legal insecurity have acted as barriers to investment in the regions most affected. Moreover, illegal money laundering from drug-related activities has channeled huge financial resources into the formal economy, thereby blurring the frontiers between illegal and legal economic activities.

New Zealand

New Zealand is widely known for its significant structural policy reforms introduced in the 1980s and 1990s. These reforms have had a largely positive impact, and the resulting policy settings, despite their unpopularity at the time, have remained largely intact. Yet New Zealand is also often cited as a country for which free-market reforms have not yielded the improvements in productivity, economic growth and living standards that were anticipated and promised by reformers. Critics of the previous Labour Party-led government (1999 – 2008) hold it responsible for an alleged lack of progress. Particular concerns have been directed toward the design and objectives of some of the new regulations, while other explanations for poorer-than-expected growth focus more on New Zealand’s small size and remoteness, and to skill shortages on the labor market.

Interestingly, although the demand for a return to growth became more insistent after the National Party-led government took office in 2008, substantive policy change since then has been relatively modest. Some blame the minority nature of the National-led government for the slow and incremental nature of change. However, given that the National Party has been able to implement a vast majority of its economic initiatives, responsibility has less to do with its fiscally conservative and compliant junior partners than with the cautious, pragmatic and poll-driven nature of the party’s economic agenda under the leadership of Prime Minister John Key. This is not to ignore the wider context of the world financial crisis, which drove the New Zealand economy into recession, albeit less severely than in
many other Organization for Economic Co-operation and Development (OECD) countries. Fiscal surpluses, due in part to earlier reforms, swung to deficits. Getting back to a balanced budget has since been the pre-eminent issue on the government’s agenda. Real GDP growth slowed in the period under review as weakening foreign demand and a persistently strong exchange rate depressed exports. The inflation rate, ranging from 4% to 5% in 2011, dropped to less than 1% in the first quarter of 2013.

Citation:

Slovakia

Score 6

The Slovak economy has recovered quickly from the great recession and has shown one of the highest growth rates in the OECD and the European Union in the period under review. However, FDI inflows, which had driven the strong growth before the great recession, have fallen, and the appreciation of the euro vis-à-vis other East-Central European countries outside the eurozone has reduced the international competitiveness of Slovakian exporters and the attractiveness of the country as an investment location for export production (Fidrmuc et al. 2013). The Radičová government put strong emphasis on fiscal consolidation and on maintaining Slovakia’s reputation as a dynamic, business-friendly country. In contrast, the Fico government has adopted a more statist approach. Measures such as the abolition of Slovakia’s famous flat income tax, the re-tightening of labor market regulations and the weakening of private pension and health insurance funds have raised concerns about a deterioration in the business climate in Slovakia.

Citation:

Australia

Score 5

While Australia’s economy has grown remarkably in the last two decades, economic policy has failed to prepare the economy for the 21st century. Australia continues to be extremely dependent on the export of natural resources, and the end of the long boom in resource extraction will most likely result in a hard landing for the Australian economy. In contrast to other natural resource-dependent economies, such as Norway, Australia has not
created a future fund to cushion the impact of a downturn of commodity prices.

In fact, between May 2011 and May 2013, economic performance has been hindered by a decline in commodity prices (which nonetheless remain high by historical standards) and a weaker Australian dollar. A lack of further microeconomic and tax reforms over the last decade has also potentially contributed to the recent slowdown in economic and employment growth.

Economic policy changes over the review period included the introduction of a carbon tax of $23/ton in July 2012, the introduction of the National Disability Insurance Scheme and a major increase in school funding, though the latter two have yet to take effect as of the end of the review period.

The main barrier to integrated economic policy is the federal structure of government, and the duplication of many services and regulatory functions between the federal government and the governments of the six states and two territories. The federal system of government has, for example, proved to be a particular barrier in achieving effective management of water resources, and federalism has also proved to be a barrier in achieving cooperation across the jurisdictions. As a result, reform of many of the social services, most notably health and education, has reached an impasse. The core of the problem is the lack of any revenue-raising powers among the states, which are dependent on block grants from the federal government. However, the Labor government has had some success in recent years addressing this problem. Namely, it signed health funding agreements with all jurisdictions other than Western Australia in 2011 and reached in-principle agreement on reforms to education funding with several states and territories in early 2013.

Czech Republic

Score 5

Czech economic policy has been based on the single overriding objective of reducing the state budget deficit and thereby limiting the growth in public debt. Both were low by European standards, but the policy mix and severity of austerity measures were similar to those in eurozone member states facing severe debt crises. The result was sharp reductions in state spending and hence in GDP throughout 2012, held in check by some growth in exports. By the end of the year, export growth was stalling due to depression elsewhere in Europe. This policy is not linked to an aim of early accession to the euro, which might be hoped to lead to greater stability than the maintenance of a small, independent currency: much of the Nečas government remains wedded to its euroskeptic past. The effect has been to reduce construction of infrastructure, housing and social facilities and to squeeze potential spending on research, education and innovation which
could point to development of a more advanced economy in future. A major driver of past growth – inward investment by motor-vehicle manufacturers – has come under threat from depression in western Europe and motor vehicle exports started to decline in early 2013. The immediate prospect of this one-sided policy mix is for a stagnant, or gently declining, economy.

France

Score 5

France faces a bleak economic outlook. Structural problems, such as a rigid labor market, high unemployment, growing public debt, insufficient funding of social security systems and a lack of competitiveness, are ingrained and acute. The French growth model has been based on domestic demand, fuelled by state subsidies, budget deficits and public debt. All these problems however are well-known and have been assessed in multiple reports over the years. The call is unanimous for supply-side reforms to increase the growth potential of the French economy.

The Sarkozy government (2007 – 2012), despite reforms and the president’s activism, did not really meet the challenge. The Hollande government (since June 2012) initially did not correctly assess the seriousness of the situation and was thus ill-prepared to address the problems both in terms of strategy and sectoral measures. Faced with a rapidly deteriorating situation, President Hollande has announced (and begun to realize) measures which in sum represent a reform agenda, but has not been presented as such: public spending cuts, business tax relief (after an initial raise in business taxes), a public policy review, labor market reform, legal and financial encouragement for small and medium-sized companies, and welfare reform (family allowances, health care and pensions). However, this overreaching policy has been somewhat counterbalanced by earlier contradictory measures taken by the Hollande administration (such as the creation of new jobs in the public sector or new tax burdens for companies). The Hollande government appears to prefer “stealth reforms” in order to not anger its electoral and party base, and reforms seem timid when compared to the enormous problems the country is facing. Regardless, time is needed to see whether the Hollande reforms will produce any effect.

Ireland

Score 5

In November 2010, Ireland followed Greece in applying for a bail out from the Troika of the ECB, the European Union, and the IMF. The subsequent agreement provided the country with credits worth €85 billion in return for committing to a schedule of reducing the fiscal deficit to 3% of GDP by 2015.
This had the effect of largely removing discretionary fiscal policy from the hands of Irish politicians and decision makers and submitting the country’s economic performance and policy-making to detailed three-monthly reviews by the Troika. As well as enshrining a strict timetable for reducing the fiscal deficit and recapitalizing the financial system, the agreement committed the country to a package of economic reforms that included a schedule of privatizations and deregulations, increased labor market flexibility and led to reductions in public sector pay and staffing.

In the two and a half years since the end of 2010, the country has received plaudits for its successful adherence to the terms of the agreement, most recently following the Tenth Review Mission, which concluded in May 2013. The actual budget deficit is still running at 7.5% of GDP and the structural budget deficit has been reduced by 4.4 percentage points of GDP.

Ireland has been held up as a model of a successful austerity program in which budgetary discipline has reduced the fiscal deficit and restored investor confidence. However, many Irish economists question the validity of this interpretation, which they believe to be driven at least in part by a desire to support the restrictive fiscal policies imposed by the Troika throughout the peripheral member states of the euro zone. These critics do not believe Ireland’s success is unambiguously supported by the data. Critics point to the persistence of a 14% unemployment rate despite the resumption of significant emigration, the stagnation of domestic demand and living standards, and the poor prospects for growth over the medium term.

The government has consistently fostered a favorable environment for inward investment, particularly through a low corporation tax regime that has been under fire from several European countries. Much of the growth that has been recorded since 2010 has been due to a high level of inward investment by multinationals and a strong export performance from these firms. The export-oriented multinational sector has relatively weak links with the domestic economy and it remains to be seen if it can act as an engine of growth sufficient to bring about a broad-based recovery in Ireland.

Citation:
The recent review of Ireland’s Stability Program is available here:

The Troika’s statement on its just-completed review (the tenth to date) of Ireland’s progress is here:
Italy

The Berlusconi government during its final months (June – October 2011) and the Monti government thereafter both faced the sovereign debt crisis and the dramatic rise of interest rates for Italian treasury bonds. The swift and deep actions of the Monti government (in particular a very strong pension system reform that significantly raised the retirement age, fiscal reforms and some liberalization measures) were supported by the new policies of the ECB. They significantly improved the budgetary situation and brought the country to the point where the European Commission was ready to close the excessive deficit procedure against Italy in the spring of 2013.

Through these policies, the Italian government has also avoided the need to request the help of the new European institutions of financial stabilization, the European Financial Stability Facility and European Stability Mechanism, and has escaped major bank crises. At the same time the very strong fiscal measures have negatively affected – at least in the short term – the outlook of the Italian economy, which has plunged into recession. The fiscal treatment and the bureaucratic burdens for enterprises are still too high, thus making investments in Italy comparatively more costly. Moreover, because of the strong resistance of organized groups, liberalization-oriented reforms have not been as successful as those oriented to financial stabilization. The government was also not very successful in improving labor laws. Italian governments continue to have no serious approach in economic policy and future-oriented strategy.

Portugal

The period under analysis coincides with the bailout of Portugal by the EC–ECB–IMF Troika. The measures negotiated by the Portuguese government, both at the outset of the bailout and as time has progressed, are inevitably constrained by the terms set out by the country’s international lenders and by the overall goal of achieving sustainability in Portugal's public accounts.

This has inevitably had an impact on economic policy, which has essentially played a secondary role to the overall goal of reducing public expenditure, increasing public revenue and implementing reforms negotiated with the Troika.

The austerity measures of period 2011 – 2013 have percolated through to a substantial economic recession. GDP declined 1.6% in 2011, 3.2% in 2012 and is expected to decline a further 2.3% in 2013.
Within this backdrop, the only positive note is the improvement in the balance of trade and the increase in exports, although this has not been enough to generate economic growth or avoid growing unemployment. The Memorandum of Understanding (MoU) that Portugal signed with the Troika aimed to foster “the reallocation of resources towards the tradable sector,” with exports becoming the main engine of growth, rather than remaining the protected non-tradable sector of the previous decade. The government has sought to encourage exports, and this appears to have been achieved to some extent, with Portugal’s trade balance – chronically in deficit – generating a surplus in 2012 for the first time since 1943.

Citation:
Memorandum of Understanding (MoU) between Portugal and the EU, IMF, and European Central Bank.

Romania

Score 5

While in opposition, the parties of the current Social Liberal Union (USL) governing coalition harshly criticized the stringent austerity measures (including a 25% decrease in public sector wages) adopted by the Boc government in 2010 as part of the IMF-supported adjustment program following the global financial crisis. After coming to power in May 2012, the USL reversed some of its predecessor’s policies by starting to restore public sector wages to pre-2010 levels and granting tax refunds in the pension system, as part of an effort to woo voters in an electoral year. While these moves caused the government to miss its fiscal target for 2012, the magnitude of the changes was limited by the country’s ongoing IMF program, which after a series of delays was finally completed in late June 2013. While the coherence of the government’s economic policy is undermined by the heterogeneous policy preferences of the main coalition partners, the broad parameters of fiscal and monetary policy are likely to continue to be constrained by the need to secure the approval of international financial institutions in the context of continued financial instability in the eurozone. However, the upcoming 2014 presidential elections may once again tempt the government to resort to populist measures and undermine fiscal prudence and policy coherence.

Spain

Score 5

Since mid-2011 to mid-2013 Spain has sunk into a deep recession. The sovereign debt crisis of the European periphery started only two years after the 2008 global financial crisis, and has exposed serious internal structural weaknesses linked to a real estate bubble and massive losses of productivity from 2000 to 2010. Spain, as a member of the eurozone, has dealt with a
very difficult situation without monetary and exchange rate policies and with virtually no flexibility in its fiscal policy. Moreover, the flaws in the design of the euro have seriously damaged the functioning of the eurozone interbank system, making it difficult for Spanish institutions to refinance their debts. With sovereign risk at unsustainably high levels, social unrest on the rise and growing doubts about the banking system and autonomous regions’ finances, it is not surprising that, after Greece, Spain has been a major object of international concern.

However, and according to Powell and Steinberg (2012), the Spanish economy is undergoing its adjustment process faster than is commonly understood. Since 2011 spending cuts and structural reforms (labor market, enterprise policy, tax policy) are proceeding at a rapid pace, unit labor costs are falling significantly and productivity is rising. Most encouragingly, despite the strength of the euro, exports are booming and FDI is increasing. This means that provided Spain is given adequate access to external finance and more flexibility to meet its fiscal targets as a member of the eurozone, it may be able to return to a sustainable rate of growth in the near future.

Citation:

Turkey

Score 5

After rising 9.2% in 2010 and 8.8% in 2011, Turkish GDP rose just 2.2% in 2012 to $786.3 billion. The slowdown was due partly to the ongoing global financial crisis and partly to the desire of Turkish policymakers to slow the economy with the goal of trimming growing current account deficits. The current account deficit had increased from $45.5 billion in 2010 to an unsustainable level of $75.1 billion in 2011, of reaching 9.7% of GDP. With the 2012 slowdown, the current account deficit fell to $47.7 billion, or 6.1% of GDP. The composition of the current account deficit has changed over time, with the share of net foreign direct investment as a part of total capital inflows falling from 45% in 2007 to 20% in 2012.

The net international investment position (NIIP), defined as the value of total external assets minus the value of total external liabilities, of Turkey at the end of 2012 fell to -3.9 billion, which indicates that net foreign debt totaled $413.9 billion; thus the net foreign debt-to-GDP ratio was 52.1%. Since the change in a country’s NIIP over time is determined by its current account balance and capital gains on its international investment position, it should be noted that if Turkey’s current account deficit-to-GDP ratio were to remain at 6% and GDP were to increase at an annual rate of 5%, then the country’s net foreign debt-to-GDP ratio would increase over the long term to 126% – which
is unsustainable. Turkey must therefore reduce its current account deficit to sustainable levels, such as 2% of GDP over time.

Since one the main determinants of the current account deficit-to-GDP ratio is the real exchange rate, and since the real exchange rate has appreciated considerably over the period, sustainability of the country’s current account deficit requires that the real exchange rate be depreciated over time.

On the positive side, Turkey’s banking sector during the period was solid and in general, fiscal performance was satisfactory. GDP per capita has almost tripled in less than a decade and now exceeds $10,000, and poverty levels have decreased from 28.1% in 2003 to 18.1% in 2009. While inflation measured by the consumer price index fell from 8.6% in 2010 to 6.5% in 2011 yet rose again to 8.9% in 2012, the hourly labor cost index increased by 9% in 2010 and 2011, and by 10.5% in 2012. According to the latest figures at the time of writing, the hourly labor cost index increased by 13.7% on a year-to-year basis during the first quarter of 2013.

Concerning legislative changes that affect Turkey's competitiveness, the law on state aid and subsidies that was adopted in October 2010 establishes the State Aid Monitoring and Supervisory Council along with a State Aid General Directorate to ensure the effective application and enforcement of state aid rules, as set by the 1995 EU-Turkey Customs Union. Unfortunately as there is still no legislation to implement these monitoring bodies, the law is at the time of writing ineffective; draft regulations are to go into effect in 2013. A new commercial code, consistent with EU laws and passed in July 2012, is expected to come into force in 2013. In June 2012 the government adopted a new and generous system to encourage business investment.


There was no progress in reducing the monopolistic position of BOTAS, a state-owned crude oil and natural gas pipeline company, to strengthen the private sector. While the liberalization of the telecommunications market and the network industries is ongoing, the government is planning the gradual liberalization of the postal service and the establishment of a related independent regulatory authority.
Croatia

Score 4

Croatia has been hit harder than other countries in the Western Balkan region by the negative macroeconomic consequences of the global financial crisis that began to affect the economy in 2009. A collapse in the exports of goods and services, in the rate of credit growth and in inflows of foreign direct investment (FDI) devastated the economy. Trade only recovered to its previous level in 2011 but has since stagnated. FDI inflows recovered somewhat in 2011 and 2012, reaching around €1 billion in each year, but is still far below pre-crisis peaks. As a consequence the economy has experienced a sharp decline in real GDP, which fell by 6.9% in 2009 compared with the preceding year and by a further 2.3% in 2010. It flatlined in 2011. In 2012 the economy again declined by 2.0% as a double dip recession set in. The Milanović government has reacted to these developments by adopting what it has called a “growth-friendly fiscal consolidation.” It has reduced the budget deficit from HRK 14.8 billion in 2011 to HRK 9.9 billion in 2012 by a combination of revenue increases and expenditure cuts. At the same time, it has shifted the tax burden from social insurance contributions to indirect taxes and has introduced some tax incentives for taking on the long-term unemployed. A new law was adopted to facilitate the resolution of non-performing loans and some progress has been made to reduce the high cost of starting a business. However, these measures have not been sufficient to reverse the negative economic development. The downgrading of Croatia’s credit rating to the “junk” category in February 2013 highlights the dire economic situation.

Slovenia

Score 4

Slovenia was hit strongly by the crisis and has undergone a double-dip recession since 2009. The Pahor government reacted slowly to the accumulating problems and failed to reach an agreement with social partners on economic and social reform. The Janša government acted more decisively. It succeeded in reducing the budget deficit that had gone through the roof under its predecessor, and in passing pension, labor market and banking reforms. Preoccupied with fiscal austerity, however, the Janša government neglected other structural reforms and public investment and alienated broad parts of the public. As a result, reforms were not sufficient to prevent sovereign rating downgrades and concerns that limited access to international financial markets might force the country to apply for euro rescue funds.
Cyprus

Score 3

For three decades, Cyprus applied an economic model which ensured a sustained growth. This was a notable success, particularly given the loss of 35% of its territory and 70% of its resources, and the socioeconomic upheaval caused by the invasion of the Turkish army in 1974. The model was based on the adoption of a market-oriented economic system and macroeconomic policies. Contributing to the country’s success as existence of a dynamic, flexible, entrepreneurial-minded and highly-educated labor force; moreover, the adoption of collective bargaining procedures between businesses and trade unions secured labor-market stability. The country’s technological infrastructure, advanced legal and accountancy support services, taxation system and bilateral agreements avoiding double taxation, and efficient telecommunications networks served as additional factors encouraging a large number of foreign firms to establish a base in Cyprus. Furthermore, Cyprus’ geographic location and its entry into the EU in 2004 gave it additional advantages as a business center.

However, the policies adopted, even though successful for a time, were ultimately unsustainable. The economy proved over-reliant on sectors affected by seasonality, on the financial and building sectors, and on unproductive investments. Increases in labor costs were not matched by productivity gains. When Cyprus joined the European Union in 2004, the European Commission was critical of Cyprus’ extensive offshore sector, but no corrective measures were taken. Failure to implement long-due structural reforms and address the deteriorating state of public finances and spiraling borrowing costs left the economy vulnerable. In 2010, it became evident that deficit and debt levels exceeded the Maastricht criteria. The overexposure of the country’s two major banks to Greek debt increased Cyprus’ borrowing costs, and the country experienced numerous downgrades to its credit rating from 2011 onward, effectively cutting it off from international money markets. In response to the crisis, the government introduced measures to cut the cost of the state payroll, curb tax evasion and revamp social benefits, and trimmed the deficit to 4.2% of GDP in 2012. In July 2012, Cyprus requested assistance from the European Stability Mechanism.

In March 2013, a government elected just a month previously completed negotiations on a €10 billion bailout. This included strict budgetary and monetary conditions, as well as the particularly unpopular banking “haircut” on deposits over €100,000 held in the country’s two major banks.
Greece

Score 3

Until the winter of 2009/2010, Greece was running an unsustainable budget deficit (-15.6% of GDP in 2009), current account balance (-11.1% of GDP in 2009) and very high public debt (129.7% of GDP in 2009). The combination of this disappointing economic performance with the aftershocks of the 2008 global economic crisis brought Greece to the brink of default in early 2010. Greece’s sovereign debt crisis was prevented by the European Commission, the ECB and the IMF which, at the request of the Greek government, bailed the country out in May 2010. Since then a Troika representing the EC, the ECB and the IMF has monitored economic policy in Greece. Taxes were raised, public spending was cut and public sector wages and pensions were lowered.

A second effort to rescue Greece took place in February 2012, when international and domestic private creditors oversaw the restructuring of Greek debt. They suffered losses which helped alleviate the Greek debt. This second rescue package was also accompanied by further austerity measures, leading to further decreases in salaries and wages not only in the public but also in the private sector (- 22% decrease in the minimum monthly salary in the private sector).

The results of the above economic policy measures were mixed. A depression followed the rise in taxes and the decrease in incomes. In three years (2010 – 2012), the economy shrank by a total 19.5%. Unemployment, which was at 9.5% of the labor force in 2009, soared to 24.3% in 2012. On the other hand, in the same period the Greek economy regained two-thirds of the competitiveness it had lost in 2000 – 2009 and the budget deficit fell to 9.4% of GDP at the end of 2011. Structural reforms of the economy were delayed, even though they were included in the first Memorandum of Understanding signed by the Greek government and the Troika in 2010. It was only in early May 2013 that a major privatization, namely the sale of the Greek state-owned OPAP lottery and sports-betting authority, was accomplished. Before 2010, Greek labor relations were rigidly regulated, while in the wake of the crisis regulations were relaxed to the point of giving employers almost a free hand to offer individual, tailor-made labor contracts to prospective workers in the private sector.

In sum, it was only under pressure from the country’s creditors that Greek governments started to streamline different regimes (incomes, pensions, taxation, labor relations) in order to follow an economic policy which started bearing fruits in the early months of 2013 and may lead the country out of the economic crisis in 2014.
Hungary

Score 2

The government under Prime Minister Orbán has pursued a heterodox and unpredictable economic policy that has been strongly criticized by the economic mainstream and by international organizations and what’s more, has not been particularly successful. Economic policy has been characterized by the growing role of the state, a strong rhetorical emphasis on the strengthening of national enterprises, a critical stance toward foreign direct investment, multinational companies and the banking sector, as well by regular government attacks against the Hungarian central bank. As foreign investors have complained about additional burdens and unpredictable policy changes, foreign direct investment inflows have decreased. The special levies on the banking sector have infringed upon financial intermediation. While the Orbán government did engage in negotiations with the IMF over economic assistance, it never did so seriously, so that eventually no agreement was forged. As a result of its weak economic policy, Hungary lost ground in almost all international rankings and vis-à-vis most other countries in the region. The market sentiment toward Hungary somewhat improved in 2012. However, this improvement was not sufficient to prevent a contraction in real GDP in 2012 and general economic stagnation in 2013.
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Contact:

Bertelsmann Stiftung
Carl-Bertelsmann-Straße 256
33311 Gütersloh

Dr. Daniel Schraad-Tischler
daniel.schraad-tischler@bertelsmann-stiftung.de

Najim Azahaf
najim.azahaf@bertelsmann-stiftung.de