Economy Report

Economic Policy

Sustainable Governance Indicators 2016

SGI Sustainable Governance Indicators

BertelsmannStiftung

Indicator

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 acountry’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

Score 9

The Danish economy has exhibited a boom-and-bust pattern. Prior to the financial crisis, the economy was overheating, with low unemployment, high wage increases, and especially high increases in home prices. On the eve of the financial crisis, there were signs of a turn in the business cycle. The subsequent crisis implied a huge fall in GDP and employment.

Recovery from the crisis has been slow and output has not yet rebounded to the peak levels seen before the crisis. Present unemployment is largely structural, but still remains comparatively low.

The financial crisis created significant problems for the financial sector due to expansive borrowing and the housing price bubble. It is significant, however, that few private households went bankrupt during this period. A number of small- and medium-sized banks have merged or closed, but that process has not required a direct bail out from the government. Public finances prior to the financial crisis had already implied that there was room for an expansionary fiscal policy.

Recently, there have been improvements in employment, but growth rates remain low and the main forecasters predict growth rates in the range of 1.5% to 2% over the coming years. Comparatively, the Danish economy is performing reasonably well. Unemployment is below the OECD average, there is a current account surplus and public debt is low.

It is noteworthy that despite changes in government, there has been broad agreement on the key aspects of macroeconomic policy – the country's medium-term targets. This is an important factor for the Danish economy often being referred to as reasonably well performing. Objectively, this is in sharp contrast to the 1980s and 1990s, when Denmark was repeatedly regarded as an example not to follow.

Citation:
Danish Economic Councils, The Danish Economy, Various issues. Latest issue: Autumn 2014 report, English summary available at: http://dors.dk/graphics/Synkron-Library/Publikationer/Rapporter/Efter%E5r%202014/Trykte%20rapport/E14_English_Summary.pdf

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OECD, Economic Surveys. Denmark. January 2014 http://www.oecd.org/eco/surveys/Overview_Denmark_2014.pdf (accessed 16 October 2014).

Regeringen, Et Danmark der står sammen. Regeringsgrundlag. October 2011. http://www.stm.dk/publikationer/Et_Danmark_der_staar_sammen_11/Regeringsgrundlag_okt_2011.pdf

The Danish Government, "Together for the Future: Government Platform, June 2015." http://stm.dk/multimedia/TOGETHER_FOR_THE_FUTURE.pdf

European Commission, European Economic Forecast Spring 2014. http://ec.europa.eu/economy_finance/publications/european_economy/2014/pdf/ee3_en.pdf (accessed 16 October 2014).

Poland

Score 9

The recovery of the Polish economy from its slowdown in 2012/13 has continued in 2015. The country's strong economic performance has been facilitated by stable domestic consumption, low inflation and a good overall economic framework including low labor costs, a well-functioning financial system, a high degree of continuity in economic policy, and a well-functioning administration by regional standards. Considerable EU-supported infrastructure investment has underpinned the increase in economic activity.

United States

Score 9

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 generally low taxes, less regulation, lower levels of unionization, and greater openness to foreign trade. Although its probusiness policies have had some social costs, including the rapid growth of income inequality, the country has enjoyed superior levels of growth, capital formation and competitiveness over the past two decades.

Obama’s economic policy was formed in response to the 2008 financial and economic crisis. During the period under review, the administration continued an expansionary fiscal policy to stimulate the economy. As a result, the U.S. economy has been recovering. GDP increased at an annualized rate of 3.9% in the second quarter and 2.1% in the third quarter of 2015. This increase in real GDP mainly reflected a rise in consumer spending. Spending on nondurable and durable goods increased. Spending on services also increased, notably on health care.

After several years of costly brinkmanship, successful negotiations between the Obama administration and congressional Republicans in 2015 avoided government shutdowns, authorized necessary debt-limit increases, and incorporated modest Republican-proposed cuts in the long-term growth of “entitlements” spending (e.g., Social Security, Medicare, and Medicaid). Austerity policies in combination with revenue growth reduced the federal budget deficit to 2.5% of GDP in fiscal 2015. The long-term debt picture still has adverse implications for monetary stability, and undermines business confidence. Nevertheless, investors have not lost their enthusiasm for U.S. government bonds.

Citation:
Bureau of Economic Analysis, GDP Growth Rate Revised Up, November 24, 2015, http://www.bea.gov/newsreleases/national/gdp/gdphighlights.pdf

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 continues to be quite weak. There are still areas where Canada’s economic framework is not as conducive as it might be to productivity growth. One factor is the country’s dependence on natural resources, which account for roughly 20% of GDP. Recent price volatility in the oil and gas sector, in particular, has weakened the economy. Canada’s economy shrank for two consecutive quarters in 2015, putting the country officially into recession. Despite a corresponding drop in the Canadian dollar favorable to exports, Canadian manufacturing has been slow to recover. Interprovincial barriers to trade and labor mobility, marketing boards, which have the right to control output through production quotas, and the lack of a national securities regulator are other weaknesses in Canada’s regulatory framework from a competitiveness perspective.

The sharp drop in oil prices in 2014 and 2015 also had a negative impact on government finances, which threatened the ruling Conservative Party’s commitment to a balanced budget in the 2015 fiscal year. The Bank of Canada’s lending rate sits at 0.5%, which leaves little room for a further reduction to stimulate growth in a country with heavily indebted consumers and some evidence of a housing price bubble in major cities, especially Vancouver and Toronto.

Citation:
2015 Federal Budget “Strong Leadership,” posted at posted at http://www.budget.gc.ca/2015/docs/plan/budget2015-eng.pdf.

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 autonomous central bank, 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 external trade, markets and the private sector, complemented by active government regulation and policies aimed at limiting noncompetitive market conditions, extending social protection, and to a limited degree 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 period under review, economic growth has increased slightly, but at a lower level than originally expected. The unemployment rate was stable at approximately 6%.

On the other hand, major structural weaknesses can be observed. Low labor efficiency represents a persistent 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. Thus, Chile shows a low level of industrialization; the manufacturing sector is small and the majority of consumer, intermediate and capital goods have to be imported. Chile is also highly dependent on energy imports. Minor education-sector reforms have focused primarily on higher education, but given Chile’s economic structure, there is a strong need to enhance capacities at a technical level. In the long run, deficiencies in the education system along with low investment rates in infrastructure and R&D will probably hinder economic growth and undermine the sustainability of the country’s development path.

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. Germany's economic structure is characterized by a healthy mix of service and industrial sectors (cf. Statistische Bundesamt). A wave of reforms, affecting labor market institutions, unemployment benefits, the pension system, corporate taxation, the constitutional debt brake and the liberalization of labor migration from outside the EU, have improved Germany's competitiveness and increased its attractiveness as a destination for cross-border investment. Moreover, Germany has benefited from uncertainties arising from the European sovereign debt crisis, which has affected several other euro zone member states since the end of 2009. For example, Germany's ability to refinance its debt on international capital markets has never been better with international investors preferring German government bonds to the government bonds of other euro zone member states. As a result, the German state and wider German economy currently benefits from extremely low interest rates(IHW 2015).

The current government has dramatically abandoned the liberalizing policy agenda of previous governments in favor of greater regulation. For example, recent policies have included the introduction of a statutory minimum wage, an expansion of the pension system, an increase in state support for nursing care and plans to more tightly regulate temporary forms of employment. Moreover, although trade unions and employers' associations have eschewed ideology in setting wage policy and granted firms significant flexibility, there has been a change in wage policies. Germany's recent robust economic performance and buoyant labor market have led to an increase in wages and a slight increase in unit labor costs. Yet, neither greater government regulation nor increased wages have undermined Germany's export performance or employment growth. Meanwhile, higher wages have also stimulated domestic demand, which has further reduced Germany's large current account surplus.

Citation:
Leibniz-Institut für Wirtschaftsforschung Halle (IWH) (2015), Pressemitteilung: http://www.iwh-halle.de/d/publik/presse/30-15.pdf

Ireland

Score 8

Following Ireland's exit from the Troika bailout regime at the end of 2013, recovery got underway during 2014, with real GDP growing by 5.2%. An increase of 6.2% is forecast for 2015. These high growth rates have boosted tax receipts and contributed to reducing the General Government Balance to -2.1% of GDP in 2015.

The 2016 budget marked "the end of austerity" by making significant reductions in direct taxes and raising some welfare payments, including the child benefit. It also introduced some supplementary increases in spending for 2015, notably in the health sector. These had the effect of increasing the base used by the European Commission in calculating the increase permissible in 2016 under the EU Expenditure Benchmark. Even when these expansionary measures are taken into account, the fiscal deficit is forecast to fall to 1.2% of GDP in 2016 and the debt-to-GDP ratio to decline to 93%. If these forecasts prove accurate, Ireland will make the progress required under the rules of the Stability and Growth Pact toward the Medium-Term Budgetary Objective (MTO) of a balanced structural budget.

The rapid improvement in the fiscal situation has been aided by the continuation of several favorable external developments, such as the fall in the euro exchange rate against the dollar and sterling, lower imported energy costs, relatively rapid growth in US and UK markets that are particularly important for Irish exporters, and the continued low interest rate environment in the EU. International financial markets rapidly revised their view of the Irish economy as growth resumed and now show confidence in the soundness of Irish fiscal policies, as reflected in the fall in the yield on long-term government debt, which peaked at over 12% in mid-2011, to 1.2% in 2015.

A high level of inward investment by multinationals and strong export performance by these firms were also important factors in the Irish recovery. The most serious criticism of current Irish economic policy is that the combination of favorable external developments listed above is being built into forecasts of economic growth and revenue buoyancy. According to this criticism, not enough of the fruits of the present growth spurt have been devoted to debt reduction, with too much used for increased spending and tax reductions that could prove difficult to sustain in the event of an adverse external shock.

Citation:
Budget 2016 and related background documents are available here:
http://www.budget.gov.ie/Budgets/2016/Documents/Budget%20Book%202016%20-%20full%20document.pdf

Latvia

Score 8

Latvia met its long-standing economic policy goal of joining the euro zone on 1 January 2014. At the time, its economic growth rate of 4.1% was the highest in Europe. Following a difficult period of economic adjustment and after fulfilling its ambitious fiscal consolidation targets, Latvia's economy rebounded, returning to the international markets and to favorable economic growth rates. While international turbulence has contributed to a slowing of Latvia's annual growth rate to 2.4% in 2014, this rate remains well above the EU average.

Latvia's economic policy had been governed by parameters accepted as part of financial assistance provided by the IMF and EU. As this assistance has since been repaid, these parameters have been withdrawn. While these parameters led the economy into a difficult period of adjustment, they provided a framework in which the economy established fiscal discipline. For example, in 2013, Latvia introduced legislation that placed a cap on the public budget deficit and launched a multi-year planning cycle.

Since meeting its long-standing economic-policy goal of joining the euro zone, Latvia's focus has necessarily shifted to longer-term issues of maintaining competitiveness within the euro zone and addressing social inequalities. Structural reforms are planned within the areas of education and science, innovation policy, the energy market, and the judicial system, among others. These reforms will be key to securing Latvia's future economic competitiveness. Yet the government's commitment to and ability to implement these reforms is weaker than for euro-related policies. Significant parliamentary and stakeholder resistance has stalled reforms to the education system and delayed the opening of the energy market to competition, for example. Stakeholder resistance and political-party disagreements have significantly slowed other reforms such as improving the management of state-owned enterprises or reforming insolvency laws. While Latvia's foreign-policy priority of joining the OECD will return reforming state-owned enterprises' management and oversight to the policy agenda, other areas are likely to see little change in the medium term.

Citation:
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2. Central Statistical Bureau (2012), Growth Rate Indicators, Available at: http://www.csb.gov.lv/en/real-gdp-growth-rate, Last assessed: 20.05.2013.

3. Central Statistical Bureau (2013), "Employment is still growing," Update, Available at: http://www.csb.gov.lv/en/notikumi/employment-still-growing-36470.html, Last assessed: 20.05.2013.

4. IMF (2014), Article IV Consultation Report, Available at: http://www.imf.org/external/pubs/ft/scr/2014/cr14115.pdf, Last Assessed: 02.11.2014

5. European Commission (2013), EU BOP Assistance to Latvia - Second Review Under Post - Programme Surveillance, Available at: http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/pdf/lv_efc_note_2nd_pps_mission_en.pdf, Last assessed: 21.05.2013.

Lithuania

Score 8

Lithuania's economic policies have created a reliable economic environment, fostering the country's competitive capabilities and improving its attractiveness as an economic location. At the end of 2015, the World Bank ranked Lithuania 20th worldwide in terms of ease of doing business. The individual attributes of registering property (2nd place), enforcing contracts (3rd place), and starting a business (8th place) were assessed the most positively, whereas those of paying taxes (49th place) and access to electricity (54th place) received the lowest rating. It should be noted that labor-relations regulations were not assessed in this edition of the survey. On this indicator, Lithuania used to be ranked relatively low, but the newly prepared "social model" that addresses this topic is under consideration in the Lithuanian parliament. It has been welcomed by major business associations, in particular Investor's Forum. However, due to the elections approaching in the fall of 2016, many doubt that the ruling coalition will be able to produce a consensus on its proposed reform of the country's relatively rigid labor-market rules. The country was also ranked 36th in the World Economic Forum's 2015 – 2016 Global Competitiveness Report, scoring above its overall average on some aspects such as technological readiness (ranked 22nd worldwide) and higher education and training (24th place worldwide), but falling significantly below its average for factors such as market size (78th place worldwide) and financial-market development (57th place).

The European Commission has 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. A new economic challenge has arisen from Russia's ban on some imports from the European Union, in place since autumn 2014. This has disproportionately affected Lithuania, as its ratio of food exports to Russia to GDP was the highest in the EU. Despite a slowdown in export growth due to trade-restriction measures and the recession in Russia, it is expected that private demand will continue to remain strong in Lithuania. However, according to European Commission forecasts, after several years of growth rates above the EU average, Lithuania's expected GDP growth of 1.7% in 2015 is likely to be below EU's forecast average of 1.9%.

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. However, the government formed after the 2012 parliamentary elections continued and completed some of its predecessor's projects. Construction of the new liquefied-natural-gas terminal (LNG) was finished in December 2014, for example, and another important project establishing electric-power transmission connections with Sweden will be completed by the end of 2015, with similar network links to Poland slated to become operational in 2016. These projects are expected to provide alternative energy-supply sources, and have received significant attention. If an appropriate regulatory environment is created allowing good trade relations in the natural-gas and electricity sectors, the completion of these projects should also contribute to cheaper energy prices and more competitive business conditions in Lithuania. The current government has presented Lithuania's accession to the euro zone in January 2015, another major economic policy event, as a signature achievement.

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. Streamlining the regulatory environment for businesses is one of the few areas where some progress has been achieved, especially in terms of the number of procedures and days required to start a new business (9th place worldwide). However, the country was ranked only 103rd in the World Economic Forum's 2015 – 2016 Global Competitiveness Report in terms of the burdens imposed by government regulation, and inefficient government bureaucracy remains the most problematic factor for doing business in the country, according to business executives surveyed. As the economy recovered, with Lithuania becoming in recent years 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. More progress has been made in recent years on the renovation of apartment blocks, which contributes to improving the energy efficiency of housing.

Citation:
COMMISSION STAFF WORKING DOCUMENT, country report Lithuania 2015: http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_lithuania_en.pdf.
See the 2015-2016 Global Competitiveness Report of the World Economic Forum: http://www3.weforum.org/docs/gcr/2015-2016/Global_Competitiveness_Report_2015-2016.pdf

Malta

Score 8

Economic planning is at the forefront of Malta's policymaking process and a clear-cut assignment of tasks to government institutions is its strength. Strong ties between public institutions, economic planning ministry and social partners exist. The government retains final decision-making powers; however, consultation with social partners through the Malta Council for Economic and Social Development occurs regularly. Because of these strong ties, economic growth has been and is expected to continue to be strong. Between April and June 2015, Malta's GDP grew by 5.2% in comparison to the EU's 1.6%. Furthermore, Malta's labor market has demonstrated its resilience and boasts one of the lowest unemployment rates in the euro area. Current industrial legislation provides protection against dismissals and allows for open bargaining between employers and their unions, but little co-determination structures.

During 2014, Malta's economic growth rate and labor market indicates were among the best in the EU. Significantly, the unemployment rate decreased from 6.4% in 2013 to 3.25% in 2015. Meanwhile, the European Commission's Macroeconomic Imbalance Procedure no longer deems Malta to be at risk of unsustainable economic imbalances. However, the European Commission warned of an erosion of competitiveness due to losses in the export market. The latest European Economic Forecast projects that Malta's robust economic performance will continue, stating that "real GDP growth is forecast to accelerate slightly to 3.6% in 2015 before moderating to 3.2% in 2016."

The World Economic Forum's 2014 Global Competitiveness Index highlighted improvements in the country's macroeconomic climate, spotlighting the government's balancing of the budget, an increase in gross national saving and a downward trend in inflation. However, the report indicated that Malta ranked poorly with regard to the number of procedures necessary to start a business, as well as the number of days needed to start a business. Meanwhile, the 2015 Global Competitiveness Index also identified the inefficiency of government bureaucracy as the most significant obstacle to doing business in Malta. Other limitations included an insufficient capacity to innovate, a low-skilled workforce and inadequate physical infrastructure. The country ranked in the top 20 in terms of access to loans, soundness of its banks, availability and affordability of its financial services, and internet bandwidth. The World Bank's Doing Business 2014 report highlighted voluminous regulations that hinder business, though the report registered a slight improvement in this area. The government is responding to these challenges by cutting bureaucracy, such as introducing electronic procurement and reducing the tender adjudication period. This is coupled by the fact that businesses are now benefiting from lower utility tariffs. It is also significant to note that the World Bank's 2015 report ranked Malta's ease of doing business 94 out of 189 countries.

Citation:
European Economic Forecast Winter 2013 p.66
Times of Malta 30/09/15 Malta slips down the competitive index
Times of Malta 29/11/15 EU Alerts Malta to Competitive erosion
Pre-Budget Document 2014
vision2015.gov.mt
Global Competitiveness Report 2011- 2012
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Times of Malta 79% of investors see Malta as attractive, down from 91% three years ago 8/10/2014
Times of Malta Moody's affirms Malta's A3 rating with 'healthy outlook' 28/10/2014
Times of Malta Archaic laws to face the chop, COLA to stay, 27/10/2014
Global Competitive Index 2014
World Bank Report 2014
Sharp Rise in Malta's Trade Deficit as Exports, Imports Decline Times of Malta 12/05/14
Malta National Reform Programme 2015 p.3, p.5
European Commission Memo 'Commission concludes in-depth reviews of 17 Member States to check for macroeconomic imbalances' 5/03/14
European Economic Forecast Spring 2015 p. 100
Pre-Budget Document 2015 p. 55
Doing Business 2015 – Beyond Efficiency p.202
http://www.timesofmalta.com/articles/view/20150905/local/malta-with-highest-growth-in-gdp.583179
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http://www.timesofmalta.com/articles/view/20151007/local/updated-malta-gains.587282

Netherlands

Score 8

After a long period of recession, the Dutch economy entered a period of fragile recovery in 2014 –2015, later than many other European countries. Economic activity, export, consumption, investment and employment levels are all up, and the housing market is climbing; although overall GDP was still 2% below its 2008 level at the time of writing. Inflation rates are exceptionally low, as are interest rates. This is largely due to favorable external circumstances such as low oil prices, low interest rates thanks to European Central Bank (ECB) policies, and a cheaper euro.

The comparative international situation of the Dutch economy still looks fine. In terms of GDP per capita, the Netherlands ranked sixth in the world in 2014. The World Economic Forum's Global Competitive Index places the Netherlands at rank eight overall (upgraded to sixth place in terms of sustainable competitiveness) with high scores for higher education and training, world-class infrastructure, health and primary education, goods-market efficiency, and technological readiness. The WEF criticized the country for its hiring/firing and wage-determination practices, insufficient access to credit, and an inefficient government bureaucracy.

In sum, although the Netherlands was caught in a long-term slump, recovery has commenced. A very different interpretation of the same state of affairs suggests that in spite of having followed neoliberal economic policies, traditional cycles of economic growth and recovery are no longer to be expected. Therefore, the Scientific Council for Government Policy (WRR) has urged the government to rethink the Netherlands' long-term economic structure by investing in future earning capacity so as to expedite innovation and make the economy more resilient in terms of labor productivity and transnational value chains.

Citation:
CBS (2015), Nederland in 2014 (www.cbs.nl).
Schwab, K.Insight Report. The Global Competitivenss Report 2014-2015, Full Data Edition, World Economic Forum, 2014
WRR (2013), Naar een lerende economie. Investeren in het verdienvermogen van Nederland, Amsterdam University Press
"Rutte II heeft een 'perfecte storm' in de rug", in NRC Handelsblad, 14 September 2015

Sweden

Score 8

The international financial press painted a positive picture of Sweden's economic policy and development during the first decade of the 2000s, and for good reason. Overall, the Swedish economy has fared comparatively well both during and after the global financial crisis, and Swedish crisis management seems to have been extraordinarily successful.

Sweden has received numerous accolades for its financial management. The Financial Times named former (2006-2014) 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 the European Union have likewise praised the Swedish trajectory of economic development and the role of government in securing and fostering that development. The government has implemented a series of reforms that have provided long-term economic stability. Also, and equally important, previous governments chose not to alter regulatory frameworks (e.g., important labor market regulations) which might jeopardize stability. Most long-term economic indicators on Sweden look good. This is particularly the case with regard to international competitiveness. Thus, it is fair to say that the institutional and regulatory framework of the Swedish economy provides basic stability and predictability.

All is not well, however. The National Bank of Sweden, fearing deflationist tendencies in the economy, lowered its “steering interest rate” to an unprecedented zero percent in late October 2014 and to a negative interest rate of -0.35% in September 2015. At the same time, unemployment also remains comparatively high, at least higher than could be expected from the hitherto Swedish full employment. The red-green government is committed to a goal of halving the country’s already lowest unemployment rate in Europe by 2020; a target which will be difficult to reach, given the current refugee crisis in Europe.

There are also growing fears (as mentioned recently in an IMF report) of an emerging bubble in the real-estate market. The National Bank of Sweden is urging the government to make mortgage compulsory and to consider reforms which would decrease or phase out tax deduction for interest rate payments. Together with increasing construction, these measures would help cool off the real-estate market in metropolitan regions.

Perhaps even more troubling, there are now signs on both sides of the political aisle to relax their commitment to the regulatory framework of the public budget and the public economy. The previous non-socialist government downplayed the importance of a surplus goal, a stance which the incoming Social Democratic and Green government after the 2014 election has shared. The argument for doing so is that there are urgent programs that require public funding. Also, by sidestepping a rule saying that the budget should be voted on in its totality, the former opposition (now incumbent) parties during the last election period succeeded in stopping individual items in the government’s budget. The current opposition (former government parties) have announced that they intend to do the same when the new public budget is deliberated in the Riksdag. All of this bodes not so well in terms of the long-term prospects of the economic regulatory framework.

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 euro zone, is contested in economic literature.

Although the institutional and regulatory framework of economic policy is robust and efficient, the governance of that system has proven exceedingly complex since the 2014 general elections. With 49 seats, the Sweden Democrats (SD) party is in a pivotal position between the Social Democratic-Green government (supported by the Left Party) and the non-socialist "Alliance." None of these parties is willing to negotiate with the SD. In December 2014, an agreement (the "December agreement") was reached between the two party blocs saying, inter alia, that parties would only be allowed to vote for their own original budget proposal. That arrangement meant that the pivotal power of the SD would erode. The December agreement, however, lasted only some ten months; in October 2015 the "Alliance" parties walked out of the accord and, thus, Sweden is once again in a difficult and unpredictable situation in terms of the government's capacity to organize parliamentary majorities and to have its budget accepted by parliament.

Citation:
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Kvist, Jon et al. (eds.) (2012), Changing Inequalities. The Nordic Countries and New Challenges (Bristol: Policy Press).
Mehrtens, Philip (2014), Staatsschulden und Staatstätigkeit. Zur Transformation der politischen Ökonolmie Schwedens (Frankfurt/New York: Campus).

Switzerland

Score 8

The Swiss economic policy regime combines a variety of elements. The common denominator is the practice of muddling-through as standard operational procedure and heterodoxy as the primary philosophy underlying economic policymaking. For example, it is a very liberal 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 illiberal 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 and strict non-tariff barriers, as well as small and medium-sized businesses and service providers producing for the domestic market. 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. The former policy of protectionism has changed considerably since the mid-2000s due to a deliberate strategy of market liberalization. This seemed to come to a halt in the period under consideration, since about 2005. For example, an amendment to the law on cartels failed, since it would have reduced the influence of the primary economic interest organizations within the competition agency's governing board. Likewise, parliament passed a law on "Swissness" in 2013, which established rules on whether a product may be labeled "Swiss made." Some rules expected to be implemented as a result would benefit strongly domestic producers, in particular farmers

Economists have attributed the Swiss economy's strong growth since about 2005 to some of its liberalizing reforms. Others point to the fact that most of the increase in domestic product is not due to higher productivity (GDP per capita), but rather to the increasing volume of hours worked, which itself is at least partially a result of population growth (1% per year, mostly due to immigration). This growth is conditional in export markets. In the past 15 years, Switzerland's current account balance has been positive, with exports exceeding imports. A considerable share of recent economic growth is therefore export-driven, which makes Switzerland very much dependent on export markets. The appreciation of the Swiss franc since 15 January 2015 and the country's increasingly rocky relationship with the EU pose imminent dangers to the continued success of its export-oriented economy.

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.

Industrial policy as a means of actively influencing industrial structure has been eschewed by the Swiss government. Rather, the government has restricted itself to facilitating the modernization of industries by creating favorable conditions for economic activity. In the financial field, Switzerland has improved its surveillance of banks and has set high standards for prudential banking regulations since the onset of the "great recession" in 2008.

The country's policymakers have long placed particular emphasis on maintaining a prudent fiscal policy (low deficit and debt levels) and price stability. This prudence 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 that might imply 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. The support of the UBS turned out in the end to be a success for taxpayers.

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, when the proportion of highly skilled employees among immigrant workers rose. In 2014, the share of foreign workers with tertiary education among all foreign workers is almost the same as this share among Swiss employees (36% as compared to 37%). In contrast, the share of foreign workers with low qualifications among all foreign employees is more than double (25.6%) the respective share among Swiss employees (11.5%), which has contributed to growing social tensions. 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 might have eroded. For example, the 2014 initiative capping immigration has won majority support among all educational groups except those with tertiary education at universities and universities of applied science or those with a high school diploma. But even within these groups, the initiative received 30% or more.

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. Moreover, liberalization was accelerated by the bilateral treaties with the European Union. Even beyond these treaties, practically all new economic law has followed EU standards. As a consequence of globalization and Europeanization, most 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 complementarity 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 liberalization period. 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 turned to lobbying on an individual-firm basis.

On a related note, Switzerland has not yet solved the question of its long-term relationship with the European Union. In the 2014-2015 period, the quest for politically and economically sustainable solutions became more pressing. Previous 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 instead 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 faces major problems today. The European Union has requested new institutional solutions to complement and reinvigorate the bilateral relationship. It argues that the implementation and update of bilateral agreements has become too costly in terms of time and internal conflict. Specifically, the EU has insisted on the creation of independent institutions for the settlement of disputes on the basis of the bilateral agreements, as well as mechanisms for updating bilateral agreements without having to resort to new full-scale negotiations. As of fall 2015, no new institutional solutions have been found yet. Rather, in October 2015, the negotiations on an institutional agreement came to a halt, making a new start necessary, thereby calling Swiss-EU relations into question. Given the country's close integration with the EU market – between 59% (2010) and 45% (2014) of Swiss exports go to the European Union, and between 78% (2010) and 66% of its imports come from the EU – Switzerland is highly dependent on a functional working relationship with this much larger economic partner, although the importance of EU trade has declined somewhat in recent years. By contrast, the EU is much less dependent on Switzerland.

The public initiative to cap immigration when it serves Swiss economic interests that was passed in February 2014 has exacerbated EU-Swiss tensions. Any international treaty that is not compatible with this limit must be renegotiated or terminated within three years. The treaty between Switzerland and the European Union on the free movement of labor will either need to be renegotiated or Switzerland will effectively deliberately violate the treaty. However, shortly after the initiative's passage, the EU signaled that it was not willing to enter negotiations on this issue. This poses a major challenge for the Swiss economy and economic policy, since it endangers the inflow of the (highly skilled) labor from the European Union on which the Swiss economy in combination with access to international markets depends. Since the treaty on the free movement of labor is also linked with several other important bilateral treaties – if one treaty is terminated, the other treaties are also terminated automatically – this represents a major threat to economic exchange between Switzerland and neighboring EU nations. At the moment, there is no solution in sight, and in all likelihood, Switzerland will have to give in – which may give rise to considerable frustration among those citizens who voted "yes" in February 2014 and who expect their government to reduce the inflow of foreigners.

Broadly perceived as a laggard in the development of its welfare state, Switzerland 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. It is far from clear whether these high rates of growth can be realized in the future, in particular if the inflow of foreign labor from and trade with the EU is negatively affected by the implementation of the constitutional article on mass immigration.

United Kingdom

Score 8

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 toward 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.

Because of the financial sector's increased share in the economy, the United Kingdom was badly hit by the financial crisis, which began in 2007. As a result of the financial crisis, revenue from taxes on the banking and consumer sectors fell, while public expenditure increased due to rising social security costs and government support for failing banks. In contrast to many EU partner countries, the government was relatively quick to respond to problems in the financial sector. Consequently, the provision of credit has roughly returned to pre-crisis levels.

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 care spending. The corollary, especially as service charges on government debt increased, was that cuts in other areas of public spending had to be even deeper. As a result, these cuts have been very political, and have led to a reshaping of the structure and role of the state. While initial assessments of the strategy were predominantly critical, the situation has improved in recent years. GDP growth was at a rate of 2.3% in the summer of 2015 and employment has reached another all-time high at 31.2 million people employed. However, the current-account deficit, which peaked at 5.1% of GDP in 2014 and is projected to improve marginally in 2015 to 4.3%, is the highest in the EU. This is indicative of the continuing export weakness of the UK economy, which is due largely to weak demand from the euro zone - the UK's largest export market. There are also concerns that the robust GDP performance has been driven mainly by consumer demand and that private debt is still high. The Conservative government elected in May 2015 has announced plans to stimulate economic activity in northern England, under the slogan "the Northern Powerhouse," in an attempt to achieve a regional rebalancing of the economy and also has plans to boost physical infrastructure investment.

Austria

Score 7

The Austrian economy has remained in good shape despite a difficult European context. A significant part of that success is due to the presence of 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 (to the disadvantage of the younger generations), a trend that clouds the outlook for the young generation and the future of Austria's economy more generally. In addition, there is considerable uncertainty associated with the public transfers that will be needed in managing the recent influx of migrants.

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.

Estonia

Score 7

As an EU member state, Estonia forms its economic policy in accordance with EU strategies and has adopted a reform program, "Estonia 2020," that describes a set of objectives intended to improve the national economy's competitiveness. The two central such objectives are increasing productivity and employment in Estonia. 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 implementation of the national R&D strategy. These two strategies are supposed to be complementary but duplication and lack of synergy between ministries have been continuous problems. A clear example of lacking coordination is the 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, is also an important actor in economic policy. In addition to a lack of coordination between ministries, the tensions between two governmental agencies – Enterprise Estonia and the Estonian Development Fund are getting bigger. A recent report by the economic committee of the Riigikogu revealed concerns including a duplication of functions, unclear priorities and insufficiently precise definition of action areas.
During the last year, the government has placed a strong emphasis on increasing the efficiency of tax administration. Despite good intentions, the actions have met with

criticism from SMEs and large enterprises alike. Large enterprises advocate a major tax reform (including the introduction of income tax for businesses), while SMEs have simply charged that the government measures fail to reflect the reality of doing business at their level. The tax-administration case serves as a good illustration of the broader problems that emerge when poorly communicated government initiatives are met with resistance and frustration on the part of businesses.

Finland

Score 7

The Finnish economy has not recovered to its pre-recession levels of 2008. In fact, the economy has now contracted for three years in a row, with gross national product contracting in the April – June 2015 period for the fourth consecutive quarter. Furthermore, even as other Nordic countries are emerging from recession, Finland faces continued negative growth and the imminent threat of losing its AAA rating due to a decline in export competitiveness, weakened investment and subdued private consumption. The impact of the recession on public finances has been so strong that a full recovery will probably not be achieved for several years. Fiscal policy is a particular concern, as public debt is growing. Debt will pass 60% of GDP in 2015, and will probably continue to grow until 2019. Government expenditure totaled 58.7% of GDP in 2014, among the highest such ratios in the EU. With the aim of restoring fiscal sustainability, the government is placing a high priority on greater budgetary prudence and eventually budgetary balance. The government is also seeking to raise the minimum statutory retirement age, while improving incentives for people to continue working into later life. Furthermore, government has been working toward a reform of the wage-setting system, as well as significant and much-needed reforms of the retirement system. These measures are crucially important, as further fiscal consolidation will otherwise be needed to manage the increasing costs associated with Finland's aging population.

While the Finnish economy continues to be among the world leaders in several measures of economic freedom, the country's overall performance has declined. Finland's economy was ranked 19th worldwide in the Heritage Foundation's 2015 Index of Economic Freedom, slipping several places from its 2012 rank of 16th. This relative decline can be attributed to deteriorations in fiscal freedom, business freedom and the management of government spending. Still, during the assessment period, the government successfully maintained monetary stability and encouraged entrepreneurship. In addition, Finland remains open to international trade and investment, with transparent and efficient investment regulations.

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Israel

Score 7

Like other countries, the Israeli economy was affected by the world economic crisis. Nonetheless, it achieved a growth rate of more than 3% in 2010, higher than that of most industrialized countries, and an inflation rate of 2.66%. However, during the first nine months of 2015, the annual growth rate was around 1.6% and the inflation rate fell below zero to -0.5%. The general employment rate of 62% in 2010 (ages 15 to 64) has grown steadily to 64% in the first nine months of 2015. Also, Israel's deficit is still a cause of concern. Although the country's fiscal stability was a key factor in its ability to weather the global financial crisis, it has suffered from a high deficit of around 3% since 2010.

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 to review Israel's overall policy pattern instead of looking at short-term solutions to external or geopolitical pressures. Overall, Israel dealt well with the 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. These were vocalized by the middle-class during demonstrations in 2011 and 2012, and were key issues in the 2013 elections. A 2011 report prepared by Israel's central bank identified financial-market centralization and a continuous amplification of risk as prominent problems. The government responded by reducing the risk that banks are allowed to carry for large borrowers. In 2014, the central bank issued a favorable evaluation of risk management in the bank and insurance sectors, while endorsing further cooperation between regulators.

Like many countries engaging in privatization, Israel is adapting its regulatory mechanisms. Research on water and power services shows an unorganized and inefficient regulatory system with some conflicts of interests. In general, while Israel's economic policy has its 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.

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Italy

Score 7

During the period under review, the Renzi government has been able to pursue its economic policy agenda to accelerate Italy's economic recovery, which began in the fourth trimester of 2014. This has been due to the Renzi government's fairly solid parliamentary majority, despite some grumblings from the left wing of the prime minister's party. Some of the measures introduced during the previous period, such as the income bonus for lower incomes (e.g. in the form of a monthly €80 transfer payment), tax reductions for businesses (IRAP reduction), plus a new ambitious labor law reform aimed at stimulating the economy, have started to produce positive effects. The 2015 budget has followed a careful path between respect for the euro zone's rules and support for the domestic economy. It has further reinforced the expansionary measures of the previous year. In particular, it has increased the IRAP (tax on incomes paid by employers and employees) reduction, lowered the costs of employing young people, and cut state and local authorities' expenditures. The government has also launched an important reform of public administration to reduce complexity and increase effectiveness. Efforts to further reduce inefficiencies in state expenditure were continued by the spending review. The results, while lower than expected, have been significant.

Luxembourg

Score 7

Luxembourg has been ranked highly on international competitiveness indices. In the Global Competitiveness Report 2015 – 2016, Luxembourg decreased one place to position 20 out of 140 countries. However, the countries receives less stellar evaluations on other indicators. The World Economic Forum awarded Luxembourg a poor rating in both the “inadequately educated workforce” and “restrictive labor regulations” categories.

Following a deterioration in competitiveness in 2013 as ranked by the International Institute for Management Development’s index, Luxembourg made a very strong move to the top from 11th place in 2014 to sixth place in 2015. The country scored positively with regard to policy stability and predictability, a competitive tax regime, a skilled labor force, a predictable legal framework and a business-friendly environment. The “impact of business efficiency” indicator recorded one of the largest gains, from 14th to fourth place.

However, the Foreign Account Tax Compliance Act (FATCA), the recently implemented automatic exchange of information on capital income, has had a serious impact on the country’s financial sector, which provides a third of Luxembourg’s GDP. The European Union has also modified its VAT regime for electronic commerce to the detriment of Luxembourg, which has been home to many e-commerce companies due to its favorable tax rates. This led to a loss of about €650 million in tax revenue in 2015 (although following negotiations with the EU Commission, this policy will be implemented incrementally through 2018), obliging the government to increase its general VAT rates. Thus, Luxembourg is facing massive challenges: New hubs and business clusters have been created in an effort to generate new revenue sources. The Luxembourg Cluster Initiative, for example, is focused on several high-priority economic sectors. Luxembourg has 19 data new centers; however, they still need to be closely connected with cluster initiatives to ensure that the investments yield results and that ICT companies actually use the data hubs. Moreover, the available amounts of venture capital, private financing and start-up investment financing are rather low in international comparison, and need to be reinforced. Therefore, the state lending agency (SNCI) is intensifying its activities. E-government applications have streamlined some operational processes, such as the introduction of new online tax returns for companies in October 2015.

To grow, Luxembourg must expand its labor force with highly skilled workers. According to employers’ organizations, the government must continue to focus on accelerating the pace of administrative work and procedures, as well on reforming the automatic salary index mechanism, which raises wages automatically in parallel with inflation rates.

The country's generous welfare model has to be reformed to adapt to a reality of more modest public resources and budgets. In the long-term view, Luxembourg appears to face a medium level of fiscal sustainability risks. The European Commission agreed with this macroeconomic scenario in its evaluation of Luxembourg's Stability Program 2012 – 2015, highlighting concerns over the country's overly optimistic economic-growth outlook and its inability to address age-related expenditures.

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Norway

Score 7

The decline in oil prices has affected the Norwegian economy, with the sharp fall in prices over the last year creating a strong impact. The economy is struggling with reduced investments in the offshore industry, with the implications being felt across the economy. The economy is on a less steady footing now than was the case a year ago. Public finances are still solid, although the parliament has had to relax its self-imposed constraints on the use of petroleum revenues to cover current spending. The country has long enjoyed strong economic growth and near-full employment, and has benefited from a well-functioning system of tripartite cooperation. However, growth rates are slowing and unemployment rates are increasing. 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 currency has lost about a third of its value in a year. This reflects a slide in international confidence in the economy, but has on the other hand been beneficial from the perspective of competitiveness.

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. However, the high level of welfare benefits and high costs also represent challenges in a period of declining revenues from petroleum activities.

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. It also makes the economy vulnerable to changes in petroleum prices in world markets. These problems have now become strongly visible in the economy and a factor in economic policymaking.

South Korea

Score 7

Among the OECD countries, South Korea has shown high growth rates, with annual GDP growth of 2.9% in 2013 and 3.3% in 2014. In 2015, the economy initially suffered from weak exports and low domestic demand partly due to concerns over the outbreak of MERS that killed 36 people. However, the Korean economy rebounded in the third quarter of 2105, growing about 1%. A fiscal stimulus and record-low interest rates supported the economy. Despite this considerable growth rate over the period as a whole, the economy has fallen far short of political promises made by President Park Geun-hye in a three-year plan announced in February 2014. In this so-called 474 vision, she targeted a 4% GDP growth rate, a 70% employment rate and a per capita income of $40,000. Her second economic team appointed in July 2014, led by Finance Minister Choi Kyung-hwan, announced a $40 billion stimulus package and put pressure on the Bank of South Korea to adjust its monetary stance in harmony with the administration's pro-growth fiscal policy. Bowing to government pressure, the Bank of South Korea pulled back from its hawkish policy stance, and as of the time of writing had cut the interest rate four times since August 2014, bringing interest rates to an historic low. Park's administration also pushed ahead with a promise to reduce the "cancer of red tape," through reducing regulation primarily within the business sector. Other measures included housing-market deregulation aimed at revitalizing the housing market and stimulating growth. These policies included a relaxation of loan-to-value and debt-to-income ratios; however, critics warned that aggressive policies designed to prop up the anemic housing market could exacerbate a real-estate bubble as well as the country's heavy household-debt burden.

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Park Warns South Korea: Change or Perish, The Diplomat, February 28, 2014, http://thediplomat.com/2014/02/park-warns-south-korea-change-or-perish/
Segye Ilbo
http://www.segye.com/content/html/2015/10/25/20151025002090.html?OutUrl=naver

Spain

Score 7

Since 2013, Spain has experienced a surprisingly strong recovery, with the economy adjusting quickly after a deep double-dip recession that lasted five years (2008 – 2013). Spending cuts and some structural reforms as part of the government's National Reform Program (labor market, control of public finances, banking sector recapitalization) proceeded at a rapid pace, unit labor costs fell significantly and productivity rose. Most encouragingly, exports began booming as early as 2011 despite the strength of the euro, and after 2012, FDI increased as well. The economy began to grow strongly once sovereign risk was reduced to sustainable levels and Spain's access to finance was expanded (a result of ECB policies that contrasted with rigid pre-2012 monetary and exchange-rate policies). The European Commission's decision to grant more flexibility in meeting fiscal targets was also of help, as was the decline in oil prices.

Spain's recovery gathered momentum in 2015, with the economy growing by 3.2%, the highest such level in 10 years. Indeed, by the end of the period under review, growth had reached an impressive 3.4% annualized rate, which was much higher than that seen in other large euro zone economies. This recovery has been driven both by exports and – for the first time in several years – domestic demand. Yet dangers still lurk. The Spanish economy remained smaller in 2015 than it was in 2007, with Spaniards' per capita incomes lower. Thus, it remains premature to assume that the country has embarked upon a truly sustainable economic path, as bank lending remains limited, the public deficit is high (forcing the retention of fiscal austerity policies), inequality is becoming more severe, and unemployment rates remain at astonishing levels (20.7% in autumn 2015). This in sum has led to rising social unrest.

Citation:
Charles Powell and Federico Steinberg. "The Pain in Spain: Light at the End of the Tunnel?", The International Spectator: Italian Journal of International Affairs (Volume 47, Issue 4, 2012).

Financial Times, July 2015: Economic recoveries in Spain and Ireland accelerate
www.ft.com/cms/s/0/311eab28-36a1-11e5-bdbb-35e55cbae175.html#axzz3mNvpNJBV

The Economist, August 2015: Spain's economy, Back on its feet
www.economist.com/news/finance-and-economics/21660550-growth-has-returned-dangers-still-lurk-back-its-feet

Belgium

Score 6

Europe and the euro area are mired in a protracted economic crisis that has dealt a blow to existing economic institutions. Belgium is proud to be at the heart of Europe, but is now paying a cost because of it, and suffers from the need to implement substantial adjustments in response to this Europe-wide shock. Productivity growth has slowed substantially, and several of Belgium's previous comparative advantages are eroding. As a result, the unemployment rate has continued to rise in Belgium even as it reached a four-year low in October 2015 in the euro area as a whole.

The new federal government (Michel I) is trying address some of these problems. However, it is exceptionally right-wing for Belgium's tradition of middle-of-the-road government coalitions, and its mode of action has prompted strong political reactions that are destabilizing institutions intended for more consensual decision-making styles. This may in part lead to the weakening of some conservative special interests and produce positive changes in the future. But it also increases the risks of future reversals and further instability. In addition, economic policies often lack coherence, since competences are today largely split between the federal and regional authorities, and political majorities at the regional level contrast with those at the federal level (both the Walloon and Brussels regions currently have center-left governments).

In its May 2015 recommendations, the Council of Europe identified several weaknesses needing attention by the government. Among these were the way in which 1) pensions are funded, 2) taxes are collected, and 3) labor markets function. The government has engineered additional pension reforms to increase the effective age of retirement. However, as pointed out by the Council, this has not been accompanied by better incentives for firms to hire older workers. There is thus a high risk that the older individuals will bear disproportionate costs through higher unemployment rates today, as well as through reduced pensions in the future. Next, the tax base is too narrow, and marginal tax rates on labor too high as a consequence. The government has initiated a major "tax shift," but has not sufficiently broadened the tax base. This may lead to potentially significant budgetary shortfalls in the coming years. Such problems might mainly be transitory and prove to be due to adjustment costs (for example, through a greater prevalence of strikes due to resistance to change). In the meantime, however, the Belgian economic framework and its international competitiveness have not significantly improved.

Citation:
Council of Europe's Recommendations: http://ec.europa.eu/europe2020/pdf/csr2015/csr2015_belgium_en.pdf
Biatour and Kegels 2015: http://www.plan.be/admin/uploaded/201510021314080.WP_1506_11090.pdf
Inflation and Unemployment in Europe: http://ec.europa.eu/eurostat/web/products-press-releases/-/3-30102015-AP
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Bulgaria

Score 6

Since the late 1990s, Bulgarian economic policy has been characterized by a discrepancy between macro- and microeconomic policy. Whereas the country's macroeconomic policies – most notably the monetary regime, a currency board arrangement tied to the euro – have been generally effective, microeconomic policies have been 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 or create jobs; and subsequent governments, with their emphasis on creating a low-tax and low-wage economy, have done little to increase skill levels, foster innovation or raise productivity.

After a loosening in fiscal policy in 2013-2014, the second Borrisov government has brought the deficit under control and has made government finances more predictable. However, while some reforms in the spheres of health care, education, and labor markets have been announced, most of the country's microeconomic problems have not been addressed so far.

Czech Republic

Score 6

In the period under review, the Czech economy emerged from stagnation with GDP increases by 2% in 2014 and by about 4% in 2015. Investment in support of economic growth has increased significantly. European structural funds have been the major contributor to public investment and, to a significantly lesser degree, the state budget. The central bank has intervened in foreign exchange markets to devalue the currency. This has resulted in an increase in import prices, but makes little difference to exports which compete more on quality than on price. Overall, these strategies represent a basis for growth when demand is rising in the rest of the EU – the main market for Czech exports – but not a basis for raising the level of the Czech economy to that of more advanced countries in Western Europe.

Iceland

Score 6

Seven years after the 2008 economic collapse, Iceland's economic policy is still dominated by the fallout from the collapse. The capital controls imposed to stabilize the króna and a fiscal adjustment strategy equivalent to about 10% of GDP between 2010 and 2017 are still in place. After several postponements, the gradual relaxation of capital controls was announced in June 2015. This announcement followed an agreement between the steering committees representing creditors in the failed banks and government task forces. The agreement enables creditors to withdraw assets from Iceland, equivalent to 20% of GDP, in exchange for paying an exit tax and a commitment not to sue the government. Whether this agreement will maintain the stability of the króna, while avoiding litigation proceedings against the government, remains to be seen. The government had previously announced that creditors either had to reach an agreement with the government task forces or pay an exit tax equivalent to 39% of Iceland's GDP, approximately $6.5 billion, in 2016. The relaxation of controls will be slow and seems likely to take several years.

Following the 2008 economic collapse, the government sought to strengthen the Financial Supervisory Authority (Fjármálaeftirlitið, FME). The FME had performed before the crash, as though it had been "designed to fail." The number of FME personnel increased significantly after the collapse. However, the FME's annual budget was halved for 2013 and then again for 2014. By late 2015, the efforts of the FME and the Special Prosecutor had led to the successful prosecution of 22 individuals for legal violations connected to the 2008 collapse. The Supreme Court sentenced these individuals to a combined total of 54 years in prison.

Inflation is increasing, according to the central bank. Employers are arguing that this is due to labor unrest, including strikes, which have won wage increases causing an overall increase in prices.

The future of the banking sector remains uncertain, as the government has not presented any plans for restructuring the banks. At the time of writing, the government owned a majority stake in one of Iceland's three largest banks. Meanwhile, foreign venture funds own significant stakes in the other two banks, a temporary situation. Iceland is one of very few countries in the world without any foreign competition in its domestic banking sector.

Iceland applied for EU membership in 2009. The previous government had signaled its intention to abide by EU standards and to strengthen Iceland's institutional environment, including its regulatory policy. Due to disagreements between the previous government's coalition partners, the application process was put on hold in January 2013. In 2013, the current Icelandic government expressed its intention to unilaterally retract Iceland's membership application. A formal withdrawal was announced in the spring 2015. However, the EU and the Icelandic government disagree on whether this means that Iceland has fully withdrawn from the process. Specifically, the EU has questioned the authority of Iceland's foreign minister to unilaterally withdraw an application approved by parliament.

Citation:
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(http://en.samkeppni.is/media/reports/ICA_2011_en.pdf).
Gylfason, Thorvaldur (2015), Iceland: How Could This Happen?, in Reform Capacity and Macroeconomic Performance in the Nordic Countries, eds. Torben M. Andersen, Michael Bergman, and Svend E. Hougaard Jensen, Oxford University Press. — Also available as as CESifo Working Paper No. 4605, January 2014

Mexico

Score 6

On the positive side, the general quality of macroeconomic management in Mexico is good. The Finance Ministry and the central bank (Banco de México) benefit from a considerable wealth of technical expertise with many Mexican officials having internationally recognized qualifications in economics. 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 retain positive economic growth rates, despite the recent global economic downturn and fall in international prices. Inflation is well under control. However, the micro-economic picture is less clear, despite some recent reforms and positive developments. Mexico remains a low-skilled, export-oriented 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. The country has economic problems based on a lack of internal economic competition in key sectors such as telecommunications, with a tendency to generate oligarchies. Consequently, the current government has made increasing competiveness in domestic markets a key economic priority. However, the collapse in global oil prices through 2014 and 2015 led the Mexican government to reject proposals to offer private companies oil concessions, due to a lack of interest.

New Zealand

Score 6

New Zealand is widely known for the significant structural policy reforms introduced in the 1980s and 1990s. Despite strong early public opposition, these reforms have had a largely positive impact, and the resulting policies 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. Advocates of yet further policy reform hold the previous Labour Party-led government (1999 – 2008) and the present highly pragmatic and moderate National-led government (taking office in 2008, and governing through the end of the review period) 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, its focus on primary production (agriculture, forestry and fishing), and its skill shortages.

As indicated, 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 have blamed the minority nature of the National-led government for the slow and incremental nature of change. However, given that National has been able to implement a vast majority of its economic initiatives, responsibility may have less to do with lack of support from its junior support parties than with the cautious, pragmatic and poll-driven nature of the government'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 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. After a period of slow growth, the economy has in recent years benefited from post-earthquake reconstruction in the city of Christchurch, a strong increase in immigration, and favorable terms of trade. The inflation rate fell to 1% in 2015.

Citation:
Government at a Glance – Country Note: New Zealand (Paris: OECD 2013).
OECD Economic Outlook No. 95 (Paris: OECD 2014).
OECD Economic Surveys – New Zealand (Paris: OECD 2013).

Portugal

Score 6

Portugal's bailout by the Troika of the EU, the International Monetary Fund (IMF) and the European Central Bank (ECB) was formally completed on 17 May 2014, with Portugal achieving a clean exit from this assistance program.

However, as noted in the 2015 SGI report, which encompassed the first six months of the post-bailout period, the end of the bailout did not entirely remove the conditionalities placed upon the Portuguese government. Indeed, the Memorandum of Understanding (MoU) with the Troika stipulated, in its 2013 revision, that Portugal would have a budget deficit of 2.5% in 2015, thus achieving a level below the 3% level set by the euro zone rules.

Over the period under analysis here, economic policy did not depart significantly from the pattern described in the 2015 SGI report. By and large, the government remained committed to austerity.

However, there were three noteworthy developments in this period. First, the government did not follow the MoU as closely as it did during the bailout period. Thus, the deficit goal for 2015 was set at 2.7%, somewhat higher than the 2.5% stipulated in the MoU, even if still within the 3% target. Second, the period was marked by a relative stabilization of the government's austerity program, with the assessment of the parliament's independent Technical Budget Support Unit being that the 2015 budget maintained, but did not increase, the level of structural adjustment effort of 2014. Third, the government largely avoided major economic-policy reforms in the period here under analysis.

These developments were made possible in part by the conclusion of the bailout and the very low yields on Portugal's government bonds, both factors that reduced the pressure on the government to pursue austerity and reform policies.

However, perhaps more relevant is the fact that the period under review here, November 2014 – November 2015, coincided with the final year of the XII legislature, with legislative elections in October 2015, an environment that also proved amenable to greater stability and moderation in economic policy.

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

Unidade Técnica de Apoio Orçamental - Assembleia da República (2015), "Análise à proposta do Orçamento do Estado para 2015." Available online at: http://bit.ly/1Q4CSfX

Romania

Score 6

With a GDP growth rate above 3% in 2015, the Romanian economy has been among the fastest growing in the EU. Private consumption, which has benefited from tax cuts and strong increases in wages, is the key driver of growth. As the efforts to crack down on corruption and improve governing efficiency have increasingly improved the economic environment for domestic and international players, investment has also picked up. Various surveys have found that foreign and domestic business leaders are increasingly confident in the operation of the Romanian economy. A particularly promising sector is the IT sector which benefits from the availability of a large number of qualified IT professionals. The snowballing multinational interest in the Romanian market should facilitate the economy's medium-term prospects, though this interest does fuel concerns over external domination of the national economy.

Slovakia

Score 6

In the period under review, the Slovak economy recorded one of the highest rates of GDP growth in the EU and OECD. Economic growth was largely driven by private consumption and public investment financed by EU funds. In contrast, exports remained weak, even though the German and Czech economies, the main trading partners of Slovakia, performed relatively well. In December 2015, the Fico government succeeded in signing a major agreement with the British carmaker Jaguar Land Rover (JLR). While production won't start before 2018, investments associated with construction are estimated to increase GDP by 0.3 % already in 2016. Despite these successes, however, long-term growth prospects have suffered from the government's failure to enhance the business and investment climate by improving infrastructure and labor force skills, strengthening administrative capacities and fostering R&I. As the automotive sector already now makes up about 43% of the Slovak industry, the JLR deal is to increase the dependence of the Slovak economy on a single sector and on export performance.

France

Score 5

France still faces a bleak economic outlook. Structural problems, such as a rigid labor market, high unemployment, growing public debt, insufficient funding of social security systems, an unfriendly entrepreneurial environment and a lack of competitiveness, are ingrained and acute. Together they form a considerable barrier to the growth potential of the French economy – the key issue for economic policy.

The Hollande government (since May 2012) initially failed to 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 gradually altered his policies. Two major changes have been the so-called "Competitiveness Pact" (2013) and the "Responsibility and Solidarity Pact" (2014), which alleviate the fiscal burden on companies by €30 billion; first results were observed in 2015 (showing no real impact on unemployment as of yet). In addition, the Macron bill introduces more flexibility in regulations, somewhat decreases the protection of regulated professions, alleviates some procedures in case of redundancies and strengthens competition within oligopolistic sectors. In summary, the measures announced (and partly implemented) since 2013 are steps in the right direction and should generate positive mid-term growth effects, as OECD impact evaluations have shown. They are, however, clearly not sufficient and need to be complemented by additional reforms, especially concerning the labor market and the high tax/contribution burdens of companies. Furthermore, a clear commitment to these reforms and a perseverance in their implementation is needed in order to restore confidence.

These structural measures need time to demonstrate their effects. In the short run, the economic situation will remain poor, with low growth, high unemployment, public deficits above the 3% ceiling of the "Stability Pact" and rising public debt. Faced with these problems, and with strong political and ideological opposition to liberal reforms, the Hollande government, like its predecessors, is inclined to furtively implement reforms in an attempt to appease its electoral and party base. By doing so, his government is blurring its message and risks weakening the impact of reform policies. Prime Minister Valls and his minister of economic affairs, Emmanuel Macron, try to adopt more frankness, pointing to the necessity of structural reforms, but this message is highly contested within the Socialist Party majority.

Citation:
OCDE: France. Évaluation de certaines mesures de la Loi pour la croissance, l'activité et des chances économiques et persprectives de futures réformes. Paris, September 2015 (série "pour des politiques meilleures)

Japan

Score 5

The LDP-led government, which took office in December 2012, embarked on a so-called “three arrows” strategy, consisting of aggressive monetary easing, a highly ambitious deficit-financed spending program (despite record levels of public debt), and a program of structural reforms. In the short term, the first two arrows led to a surge of optimism in the economy, although their unorthodoxy entails grave hazards that would have been deemed irresponsible even a year before. According to The World Bank, Japan’s economy grew 1.6% in 2013. A strong devaluation of the yen in response to the monetary easing played a considerable role. Corporate profits and share prices also rose significantly. Another positive sign was that deflation was overcome, for the time being.

With only a few exceptions, progress on promised structural reforms (the “third arrow”) such as liberalizing labor markets and the agricultural sector has been much slower, frustrating many observers. The introduction of a new Corporate Governance Code in spring 2015 can be seen as a major positive step. However, the Abe government chose to expend considerable amounts of its political capital in 2014 – 2015 to push through a more assertive defense policy, somewhat losing sight of the economic reform agenda. In September 2015, Abe announced three “new” arrows, including a strong economy with a nominal economic output of JPY 600 trillion (about €4.5 trillion Euros) by 2020 — about 20% more than is presently the case. Additional new policy proposals included improvements to the child-care and social-security systems, particularly for the elderly. However, this vision lacked reference to specific instruments, thus diminishing its credibility. Many observers see it as an attempt to deflect attention from the earlier third-arrow agenda and its apparent underachievement.

Current macroeconomic developments have helped produce the disenchantment with Abenomics. Economic growth has not picked up significantly, but has instead fluctuated, with second-quarter 2015 results even slightly negative. The goals of a 2% annual inflation rate and concomitant increases in inflation expectations have not been achieved, despite a further increase in the target for annual asset purchases – mainly government bonds – to JPY 80 trillion annually (about €600 billion) in 2014. The target date for achieving the 2% inflation rate had to be extended twice, and as of the time of writing stood at late 2016 or early 2017. In its late-October 2015 board meeting, the Bank of Japan left its policy unchanged. This was interpreted by many as a signal that the central bank does not believe monetary policy (alone) can achieve the desired results, and that suitable government policies in other fields are still lacking.

The conclusion of the TPP trade agreement between Japan, the United States and 10 other Pacific states in early October 2015 could lead to significant liberalization of Japan’s agricultural sector, thus representing a major success with respect to the original “third arrow” of Abenomics, even though tariffs on rice will remain in place. However, it is not yet clear whether the government can succeed in obtaining ratification for the treaty in the face of domestic opposition even within the government parties, and TPP’s future is unclear in other states as well, including the United States. Moreover, new support schemes are being contemplated in parallel with the treaty’s enactment. However, the government has succeeded in weakening the protectionist Central Union of Agricultural Cooperatives (Japan Agriculture JA – Zenshu) by giving individual cooperatives more independence. The overall effect remains unclear.

Citation:
Takashi Nakamichi and Megumi Fujikawa, Bank of Japan Lowers Growth, Inflation Forecasts, The Wall Street Journal, 30 October 2015, http://www.wsj.com/articles/bank-of-japan-keeps-monetary-policy-unchanged-1446176117

Mina Pollmann, Agricultural Reforms in Japan Pave the Way for TPP, The Diplomat, 12 February 2015, http://thediplomat.com/2015/02/agricultural-reforms-in-japan-pave-the-way-for-tpp/

Slovenia

Score 5

As the positive economic trends from the second half of 2014 continued, the Slovenian economy kept growing strongly in 2015. Economic output is estimated to have expanded by 2.5% in 2015, following 3% in 2014. Initially driven by strong export performance, the economic recovery has become broader-based as private consumption growth has accelerated thanks to an improving labor market, rising consumer confidence and continued low energy prices. Investment in infrastructure projects co-funded by the EU also helped boost growth, while private investment began to show initial signs of recovery. In the period under review, the management of what is still a relatively large number of state-owned enterprises was put on a new footing in June 2015 when the National Assembly authorized the Slovenian Sovereign Holding on the basis of a new corporate governance codex presented in December 2014. However, concerns about economic policy have been raised by the controversies over the privatization of state assets within the governing coaliton and the dismissal of the two Swedish heads of the Bank Asset Management Company, Lars Nyberg and Torbjörn Mansson, in October 2015, which was widely perceived as an attempt to strengthen the capacity to politically influence Slovenia’s “bad bank.”

Citation:
Stepišnik, Matija, “Adijo, Švedi”, (Goodbye, Swedes), Večer, 8 October 2015, http://www.eurotopics.net/en/home/medienindex/media_articles/archiv_article/ARTICLE171035-Slovenia-s-government-wants-to-control-bad-bank.

Turkey

Score 5

Over the past decade, Turkey has experienced important gains in income and living standards. Recently, it has also improved its competitiveness. The country is relatively well positioned in global competitiveness rankings, ranking 51st in the

World Economic Forum's 2015 – 2016 Global Competitiveness Index, and 55th in the World Bank's Doing Business ranking. The 1995 EU-Turkey customs union, and the EU accession process have played a considerable role in these achievements.

After rising 2.1% in 2012 and 4.2% in 2013, Turkey's economy expanded by 2.9% in 2014. However, measured in U.S. dollars, GDP declined from $823 billion in 2013 to $798.3 billion in 2014 as a result of exchange-rate depreciation. The country's slowdown since 2012 has been driven in part by the ongoing global financial crisis, and in part by Turkish policymakers' desire to slow the economy in order to bring current account deficits under control. Other contributing factors include the fact that formerly booming regional Turkish export markets such as Syria and Iraq have been decimated by political instability and war.

Turkey's inflation rate, based on the consumer price index, decreased from 8.9% in 2012 to 7.5% in 2013, but increased again to 8.9% in 2014. The country's annual inflation rate in September 2015 was at 7.95%. Thus, headline inflation rate remains well above the central bank target of 5%. However, according to Turkey's hourly-labor-cost index, the total hourly cost of employing labor increased by 11.5% in 2012, by 13% in 2013, and 11.5% in 2014. According the most recent figures, the hourly labor costs increased by 12.8% on a year-over-year basis during the second quarter of 2015.

The banking sector has proved resilient in the face of global financial crisis thanks to robust capital buffers and a healthy loan portfolio. Turkey was the only OECD country in which no explicit or implicit public-sector support was provided to the banking sector in the wake of the 2008–2009 crisis. Turkey's most significant economic problems are related to external imbalances. The current account deficit increased from $48.5 billion in 2012 (6.2% of GDP) to $64.7 billion in 2013 (7.9% of GDP). In 2014, the current-account deficit amounted to $46.5 billion, or 5.8% of GDP, and the latest publicly available (September 2014 – August 2015) annualized current account deficit amounted to $45.3 billion. Although moderate growth and a weaker lira narrowed the current-account deficit in 2014 from close to 10 percent in 2011, Turkey still faces a considerable current account deficit. In the meantime, net foreign direct investment has been on the decline, constituting 18.9% of the current-account deficit in 2012, 13.7% in 2013, and 12.3% in 2014.

According to the World Bank, the current account deficit is expected to fall to $34.6 billion (4.4% of GDP) in 2015 as a result of lower oil prices. But Turkey's external financing requirement will still amount to about $200 billion since, in addition to a current account deficit of of $34.6 billion, the country will need $166 billion to roll over existing external debt.

Turkey's net international-investment position (NIIP), defined as the value of total external assets owned by Turkish residents in the rest of the world minus the value of total external liabilities of Turkish residents to the rest of the world, increased from –3.3 billion at the end of 2012 to -4.6 billion in 2013; this decreased to -0.5 billion at the end of 2014, but had again increased to -1.2 billion by the end of August 2015. The country's net foreign debt at the end of August 2015 thus amounted to $371.2 billion. Considering the August 2015 figure for net foreign debt and the IMF's estimate of GDP for 2015, the net-foreign-debt-to-GDP ratio for 2015 would be 51.4%.

It should be noted that the change in a country's NIIP over time is determined largely by its current account balance as a share of GDP. Thus, if Turkey's current-account deficit-to-GDP ratio were to remain at around 6%, and real GDP were to increase at its historical average annual growth 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. Calculations show that a sustainable current account deficit-to-GDP ratio lies around 2%. Since one of the main determinants of the current-account-deficit-to-GDP ratio is the real exchange rate, achieving sustainability with regard to the country's current-account deficit will require a depreciating real exchange rate over time.

Turkey's main assets include a young, dynamic population, a large domestic market, the country's geographically strategic location, a strong infrastructure and much-improved public services. However, domestic and foreign investors remain deterred by unpredictability and a lack of transparency in the business climate, and a lack of trust in key institutions. Growth since 2012 has been moderate. In 2013–2014, election-related uncertainties, geopolitical developments, and concerns over the government's handling of corruption allegations dampened confidence and weakened private demand. Moreover, Turkey has been vulnerable to changes in investor sentiment and, together with other emerging markets, has experienced significant currency and financial market volatility since mid-2013.

A major challenge facing Turkey is the reform of trade policy. Almost 20 years have passed since the EU-Turkey Customs Union Decision covering industrial commodities was signed. Negotiations over a free trade agreement between the EU and Turkey include the liberalization of agriculture, services and government procurement, which would help Turkey navigate the negative effects of a EU-U.S. free tade agreement in the form of the Trans-Atlantic Trade and Investment Partnership (TTIP). Intentions to begin reforming the Customs Union with an eye toward TTIP was made public by both Turkey and the EU in May 2015.

Citation:
World Bank (2014) Turkey's Transitions: Integration, Inclusion, Institutions, Washington D.C.: The World Bank
World Bank (2015) World Bank Group - Turkey Partnership: Country Program Snapshot, Washington D.C.: The World Bank (April).

Australia

Score 4

Australia's economy continued to be relatively weak the year-long period ending on 8 November 2015. GDP growth was well below long-term trend, while real net national disposable income had decreased by 0.7% on 30 June 2015, on a year-to-year basis. The unemployment rate was nonetheless relatively unchanged over the period, remaining at approximately 6.2% over the entire year. Australia remains highly dependent on the export of natural resources, and commodity prices continue to decline. Prices for iron ore, Australia's biggest export product, have been hit hard by the declining demand for steel in China, declining from AUD 190 per ton in 2011 to below AUD 40 per ton in December 2015. Taxation revenue has correspondingly declined as a share of GDP, resulting in a succession of substantial budget deficits since 2009. 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 in commodity prices. A lack of microeconomic and tax reforms over the last decade has also contributed to the recent slowdown in economic and employment growth.

The review period was marked by the Liberal-National coalition government's inability to secure Senate passage for budget measures seeking to reduce government expenditure. This has contributed to increases in economic uncertainty and a reduction in business and consumer confidence. The shift in prime ministers from Tony Abbott to Malcolm Turnbull in September 2015 (without a change in government) appears to have restored confidence somewhat, although few substantive policy changes had been introduced as of the end of the review period. Turnbull stresses the need for innovation and research, but continues to consider these challenges to be private-sector tasks.

The main barrier to integrated economic policy continues to be 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 has also proved to be a barrier in achieving cooperation across the jurisdictions. As a result, reform of many social services, most notably health and education, has reached an impasse. The core of the problem is the limited revenue-raising powers held by the states, which are dependent on block grants from the federal government. The Labor government had some success in addressing this problem, signing health funding agreements with all jurisdictions other than Western Australia in 2011 and reaching agreement on reforms to education funding with five of the eight states and territories in 2013. However, the Liberal-National coalition government elected in September 2013 has not committed to these agreements beyond their initial term, and indeed has announced it will only honor the first four years of the six-year "Better Schools" funding agreement.

Cyprus

Score 4

Cyprus's economic model ensured sustained growth until 2011. Founded on a market-oriented economic system and macroeconomic policies, this model enabled the country to overcome the socioeconomic disaster associated with the Turkish army invasion of 1974. A dynamic, well-educated and skillful labor force, combined with a system of collective-bargaining between authorities, businesses and trade unions secured labor-market stability and contributed to economic success. The island developed itself as an attractive business center for a large number of foreign firms by offering an advanced technological and telecommunications infrastructure, high-quality legal and accountancy-support services, and favorable taxation terms. Its geographic location and EU accession in 2004 furthered these advantages.

However, the policies pursued relied heavily on sectors characterized by seasonality, unproductive investment and rising labor costs that were not matched by productivity gains. The failure to implement structural reforms reining in a large offshore sector and balancing public finances, along with the overexposure of Cyprus' two major banks to Greek debt, had a severely negative effect on an already vulnerable economy. Ultimately the country was cut off from international markets, and issued a belated call for assistance to the European Stability Mechanism (ESM) in July 2012.

The agreement with the creditors struck by a new government elected in March 2013 imposed severe credit constraints, and demanded new policies and extensive reforms. Efforts to stabilize and reestablish confidence have led to a downsized financial sector controlled by stricter rules and enforcement mechanisms, along with measures seeking to ensure the viability of the struggling banking sector.

Strict compliance with the terms of the MoU continued in 2015, and economic growth was expected (the IMF forecast0.5%, while the EU projected 1.2%). Prospects for 2016 appeared even better. However, progress in meeting major challenges has been slow, particularly with regard to reforming the public sector, settling the issue of non-performing loans, reforming the taxation system, and restructuring and privatizing semi-governmental organizations.

Prospects for reaching a new social consensus remain clouded given that key social actors and political forces have essentially been sidelined in the reform process, and that new policies on employment, health care, wages and welfare in general have had a negative social impact.

Citation:
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Croatia

Score 3

Croatia experienced sixth consecutive years of recession from 2009 to 2014. Only after Croatia was placed under the EU's excessive deficit procedure in January 2014 were some reforms eventually launched. However, the European Commission Alert Mechanism Report of November 2014 concluded that macroeconomic imbalances remain a serious concern, falling levels of investment are undermining economic recovery, export performance is weak, and Croatia is steadily losing its share of the global market. The European Commission's June 2015 country report repeated the verdict that Croatia has an excessive imbalance that requires specific monitoring and decisive policy action. Croatia started to come out of economic recession in 2015, with GDP growth in the third quarter at 2.8% year-on-year. This was partly due to a strong stimulus from exports which increased by more than 10% in the third quarter of 2015.

However, what is disturbing and what certainly represents a fundamental challenge for Croatia is the growth of external debt accumulated over the six-year period of recession. Croatia's external debt increased from around 77% of its GDP in 2007 to 108% percent of GDP by November 2015. However, Croatia's current account balance has shifted from a deficit of €318 million in 2011 to a surplus of €340 million in 2014, which has slowed the increase in external debt and will eventually help reduce this debt should the current account balance remain positive. In addition, foreign direct investment inflows grew dramatically in 2014, showing particularly large increases from Slovenia. In order support this turnaround, Croatia must improve its export potential. Although export revenues increased in the first three quarters of 2015, exports remain at 46% of GDP.

In meeting these challenges, successive governments in Croatia have failed to implement an economic policy capable of providing a reliable economic environment or facilitating competitivenes and increasing the country's draw as an economomic location. The recent European Commission country report identifies numerous failings in the institutional setup for economic governance. These include a rigid business environment which slows growth, and strict regulations and high administrative burdens which serve as obstacles to entrepreneurial activity. Competition is limited by the near monopoly regime in which some companies operate. Finally, the large share of public enterprises in the economy creates an uneven playing field for private businesses.

Citation:
ECFIN (2014) "Macroeconomic Imbalances: Croatia 2014," European Economy Occasional Papers 179, March, Brussels: Directorate General for Economic and Financial Affairs
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Greece

Score 3

Greek economic policy is bound by the third adjustment program, based on an agreement concluded between Greece and its creditors in July 2015. The program, which provides new funds to service Greek public debt in exchange for banking, fiscal, pension, and income policy reforms, was agreed to by the Greek PM Alexis Tsipras and representatives of the European Commission, the European Central Bank, and the European Stability Mechanism, after protracted negotiations which negatively affected the Greek economy. Major goals of the new program include saving the Greek banking system, which needs recapitalization, and raising government revenue.

Earlier in 2015, negotiations between Greece and its partners had repeatedly failed to find a solution. The new coalition government of the radical left party (Syriza) and the right-wing party Independent Greeks (ANEL) sought to formulate Keynesian policies without committing to structural reforms. Indeed, there were major ideological differences between the government and its creditors over policy priorities, the former having been elected on a platform to end austerity. The negotiations obliged Athens to accept a different policy frame.

GDP per capita shrank by one-fourth between 2008 and 2014, while Gross Fixed Capital Formation was more than halved in the same period. Inflation was negative for two years in a row (2013 and 2014) and Greece still has the highest unemployment rate in the EU. In 2014, after six continuous years of negative growth, Greece achieved a positive growth rate (0.8%), but the political instability caused by two parliamentary elections and a national referendum in the span of nine months (January to September 2015), combined with the government’s meandering economic policy, produced disappointing results on all economic fronts by the close of 2015.

Greece is still required to proceed with structural reforms, linked to the EU’s bailout conditions. The EU itself has been somewhat clumsy with regard to managing Greek public debt, as it has sent mixed signals about extending the grace period, prolonging maturity dates and lowering interest rates as well as about starting negotiations on debt restructuring.

In summary, the Greek economy was slightly revived in 2014, but then derailed again in 2015. The debt is clearly unsustainable, but as long as the Greek government does not pursue long-awaited structural reforms, the country’s creditors will not give into pressures to forgive part of the Greek debt. Unemployment remains at a painfully high level, prompting fears of permanent social dislocation for the long-term unemployed. Without foreign direct investment (FDI) in tourism and agriculture as well as the privatization of state-owned enterprises and property, it is unlikely that the economy will grow in the near future.

Citation:
Information on Gross Fixed Capital Formation and GDP per capita drawn on the SGI provided by this platform. Information on real annual GDP growth drawn on Eurostat data, available at http://ec.europa.eu/eurostat/tgm/table.do?tab=table&language=en&pcode=tec00115

Hungary

Score 3

Since 2013, the Hungarian economy has once again shown growth. The unexpected surge in growth in 2014 was largely due to one-time factors such as the low base in the previous year, strong EU-financed investment favored by the closing of the previous Multiannual Financial Framework and the extremely good showing of the agricultural sector. The growth in investment came to a halt in 2015, as EU-funded investment and corporate lending have declined. A relatively high country risk premium and an unstable regulatory and tax environment have hindered FDI. As a result, Hungary's medium-term economic prospects look worse than in most peer countries. In a Eurobarometer survey in spring 2015, 69% of Hungarians described the economic situation as bad.

Citation:
Vértes, András (2015) "The Hungarian Economy: On the Wrong Trajectory" Südosteuropa, Special Issue, Hungary's Path Toward an Illiberal System, Vol. 63, No. 2, 249-271
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