Economy Report

Economic Policy

Sustainable Governance Indicators 2018

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.

Canada

Score 9

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. Falling oil prices, for instance, significantly reduced the country's export revenue and contributed to a decline in economic activity in 2015.

Following years of slow or stagnating economic growth, Canada's economy has recently gained speed. The Bank of Canada, in its Fall 2017 Monetary Policy Report, projected real GDP growth of 3.1% in 2017, up from 1.5% in 2016. Real GDI growth was projected to be even higher at 4.0% in 2017, up from 0.8% in 2016, because of improved terms of trade. Yet, it is unclear how much of this upturn can be attributed to the Liberal government's policy of increased government spending on infrastructure and other programs to stimulate the economy. While these policy initiatives were praised by both the IMF and the OECD, fiscal stimuli cannot be expected to foster economic development in the long run.

Other weaknesses in Canada's regulatory framework from a competitiveness perspective include interprovincial barriers to trade and labor mobility, and marketing boards, which have the right to control output through production quotas. These issues were not highlighted in the policy agenda of either the current Liberal government or the previous Conservative government.

Household debt remains high. The current ratio of household debt to disposable income in Canada is above 167% and continues to increase in part due to rising mortgages. Although the federal government has repeatedly tightened mortgage lending rules over recent years and provincial governments enacted legislation to curb foreign real estate investment, housing markets in Canada's largest cities, Vancouver and Toronto, remain unbalanced. A possible correction in the housing market would pose a significant risk, and there appears to be ample room for additional measures to mitigate speculative investment activity, and improve coordination between federal and provincial regulators.

A final concern is a lack of talent and innovative ability. In the World Economic Forum's most recent Global Competitiveness Report, Canada ranks below many of its OECD peers for quantity of education, technological readiness, business sophistication and capacity to innovate. The extent to which the federal government can address these issues, however, is limited. Education policy is under provincial jurisdiction and, historically, government-led attempts to actively promote technological innovation have largely been unsuccessful.

Citation:
OECD Economic Surveys: Canada June 2016, http://www.oecd.org/eco/surveys/Canada-overview-OECD-economic-survey-2016.pdf
Canada: 2016 Article IV Consultations, International Monetary Fund, June 2016, https://www.imf.org/external/pubs/ft/scr/2016/cr16146.pdf
World Economic Forum, The Global Competitiveness Report 2017–2018.
Bank of Canada, Monetary Policy Report, October 2017 https://www.bankofcanada.ca/wp-content/uploads/2017/10/mpr-2017-10-25.pdf

Denmark

Score 9

The economy has now fully recovered from the Great Recession, and the difference between actual and capacity output (the output gap) is zero. Employment has been growing and unemployment is close to the structural level, which is comparatively low.

Growth in GDP is projected to be above 2% for the coming years, and thus comparable to growth in many other OECD countries. There have been some discussions about whether Denmark was lagging behind other OECD countries in terms of productivity growth, but recent revisions indicate that Denmark is close to the international trend. However, productivity growth rates have been declining and improving productivity growth remains a challenge.

Despite the long recovery process, long-term unemployment has not increased dramatically, and youth unemployment is also low in comparative perspective. While many have been affected by unemployment, most unemployment periods have been short. The overall level of job inflows and outflows has thus remained high during the crisis, showing that the flexicurity model is still intact.

Public finances are meeting budget norms, although only by a small margin some years. Fiscal policies are considered sustainable in that they are able to cope with an aging population. This is mainly due to the significant importance of mandated labor market pensions and recent reforms increasing statutory retirement ages.

Economic policy discussions have changed focus from crisis management issues to political debates about tax decreases versus welfare. Increasing productivity growth is a key issue, which brings up questions concerning education, research, industrial and tax policies. Moreover, how to increase and support labor supply, and thus employment, remains a central issue, alongside challenges faced by the welfare systems and how to make the public sector more efficient. The liberal government launched a so-called 2025 plan addressing these issues and the new coalition government put forward a revised plan in May 2017. After failing to win sufficient political support for raising the pension age further, several measures were proposed to encourage young people to enter the labor market earlier, reduce the number of people on public support, incentivize people to stay in the labor market longer, increase the number of work hours and recruit well-educated foreign workers.

Immigration remains a contested issue, and various measures have been taken both to reduce the inflow and to reduce the welfare entitlements of migrants.
The UK’s Brexit decision is one of the elements creating a certain degree of uncertainty for the Danish economy.

Citation:
Danish Economic Councils, The Danish Economy, Various issues. Latest issue: Autumn 2017 report, https://dors.dk/vismandsrapporter/dansk-oekonomi-efteraar-(Accessed 4 December 2016). English summary available at: https://dors.dk/files/media/rapporter/2017/E17/english/e17_english_summary.pdf

Økonomi- og Indenrigsministeriet, Økonomisk Redegørelse, August 2017.http://www.oim.dk/media/18744/oekonomisk-redegoerelse-august-2017.pdf. (Accessed 4 December 2017)

OECD, Economic Surveys. Denmark. May 2016. http://www.oecd.org/eco/surveys/economic-survey-denmark.htm (accessed 4 December 2017).

The Danish Government, “Together for the Future: Government Platform, June 2015.” http://stm.dk/multimedia/TOGETHER_FOR_THE_FUTURE.pd

“Ny 2025-plan: Med disse fem greb vil regeringen få danskerne til at arbejde mere,” https://www.b.dk/politiko/ny-2025-plan-med-disse-fem-greb-vil-regeringen-faa-danskerne-til-at-arbejde-mere (accessed 22 Octiber 2017).

Ireland

Score 9

Ireland’s economic performance over the last four years has been more than impressive if judged by GDP growth. The already high GDP growth rate of 8.3% in 2014 was dwarfed in 2015 by a growth rate of 25.6%. This growth rate was dubbed as a “leprechaun statistic” by Paul Krugman and Ireland became a target of criticism in international media. Yet, because of the new accounting conventions introduced by changes to the European System of Accounts in 2010, these statistical effects cannot be removed from the official national income accounts. The main driver of the growth rates in 2014 and 2015 was multinational corporations transferring intangible assets (i.e., intellectual property rights) to Ireland, a process that created an on-shoring effect, enabling multinational corporations to allocate the profits of external activities to their Irish operations. In particular, a small number of multinational corporations engaged in contract manufacturing, whereby multinational corporations arranged with foreign manufacturers to produce commodities derived from intellectual property that had been transferred to Ireland. Under this system, the Irish-based multinational corporation pays the foreign manufacturer a fee, but the profit accrues to the owner of the intellectual property in Ireland and is attributed to Ireland’s GDP. A further driver of these high growth rates was the rise in aircraft leasing operations financed in the Irish Financial Services Center (IFSC).

The Economic and Social Research Institute noted that Gross Value Added (GVA) in the industrial sector more than doubled in 2015 with nominal GVA increasing from €41 billion in 2014 to €92 billion in 2015. Although most production took place outside of Ireland; because the intellectual property rights were registered in Ireland, production gains were attributed to Ireland (ESRI Quarterly Bulletin, Autumn 2016: 17).

Adjusting for the overexaggerated performance in 2014 and 2015, the Irish economy continued to register impressive growth of 5.1% in 2016 and 5% in 2017. A great share of this growth originated from the consumption and domestic investment sectors, a stark contrast to the previous two years when the export sector and foreign investment had largely fueled growth. Consumption expenditure had taken a major hit during the financial crisis and the lagged effects of the wealth destruction and loss of employment during that period, along with extensive financial de-leveraging, meant there was little scope for increases in consumption expenditure until relatively recently. With the sustained growth of employment and some moderate growth in incomes, domestic consumption expenditure has once again become a driver increasing the growth rate. Domestic investment, particularly in the construction sector, is once again also driving growth and will become more important in the coming years. The credibility of the strong underlying performance of the real economy in both 2016 and 2017 is borne out by sizable increases in tax revenue and considerable growth in employment. As a result of the improved fiscal position, the

General Government Balance as a percentage of GDP has fallen from -3.7% in 2014 to -0.3% in 2017. Over the same period, employment has increased by 158,000 and the unemployment rate has fallen from 11.3% to 6.2%.

Citation:
Budget 2018 and related background documents are available here:
http://www.budget.gov.ie/Budgets/2018
Economic and Social Research Institute Quarterly Economic Commentary, Winter 2017 by Kieran McQuinn, Conor O'Toole, Philip Economides. Teresa Monterro.

Netherlands

Score 9

The Dutch economy is booming. All conventional indicators of the economic cycle are performing better than their long-term averages. Prognoses by the government, major banks, and the Dutch Center for Economic Policy Analysis are continuously corrected upward.

The international situation of the economy improved, with the Netherlands ranked 4 out of 138 countries in the Global Competitiveness Index 2016-2017, overtaking Germany. The Netherlands scores highly for higher education and training, world-class infrastructure, health and primary education, goods-market efficiency, and technological readiness. The World Economic Forum praises the country for its new Work and Security Act, which attempts to improve the position of flexible workers and simplifying dismissal procedures. However, there is still fierce political and policy debate about the success or failure of this new act.

In sum, although the Netherlands was caught in a long-term slump, strong recovery has now led to a booming economy. Short-term economic challenges concern the potential impacts of Brexit, inadequate transport infrastructure (commuting, rail and truck transport), and an emerging labor shortage and wage stagnation for a considerable proportion of the working population due to strong job flexibility. A very different interpretation of long-term economic development suggests that 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 (2017), Macro-economie (www.cbs.nl, accessed 22September 2017).
Schwab, K. (ed.). Insight Report. The Global Competitivenss Report 2016-2017, Full Data Edition, World Economic Forum, 2014
WRR (2013), Naar een lerende economie. Investeren in het verdienvermogen van Nederland, Amsterdam University Press
Macro Economische Verkenningen (MEV) 2017 (consulted 20 September 2017)

Finland

Score 8

Over the past years, the Finnish economy has experienced a slowdown. In fact, the economy has contracted for several years now. Even as the other Nordic countries have emerged from recession, Finland has faced negative growth 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 not be achieved for some time. Fiscal policy has been a particular concern, as public debt has been growing and will probably continue to grow until 2019. Government spending accounts for over half of GDP, among the highest ratios in the EU.

Government efforts to restore economic growth, increase competitiveness and reduce public debt have continued to be at the top of the policy agenda. With the aim of restoring fiscal sustainability, the government has placed a priority on greater budgetary prudence and balancing the budget as well as sought to raise the minimum statutory retirement age, while improving incentives for people to continue working into later life. While the Finnish economy continues to perform fairly well in several measures of economic freedom, the country's overall performance has been in decline. 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; in 2016 and 2017, Finland was ranked in a mediocre 24th place. This decline can again be attributed to deteriorations in fiscal freedom, business freedom and the management of government spending. Still, recent economic forecasts concerning the annual GDP growth rate and several other economic indicators engender optimism. According to the Economic Survey of the Ministry of Finance in September 2017, the economy is projected to grow at 2.1% in 2018. As such, the rate of economic growth in 2017 will clearly outperform that of 2016, after which the projected growth rate will slow to around 2%. The GDP growth forecast for 2017 is 2.9%, but robust economic growth notwithstanding, due to falling private consumption, GDP growth is projected to slow to 2.1% in 2018. In 2019, GDP is forecast to grow by 1.8%.

Citation:
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"The Heritage Foundation 2016 Index of Economic Freedom", http://www.heritage.org/index/ranking;
"The Heritage Foundation 2017 Index of Economic Freedom", heritage.org/index/country/Finland;
Ministry of Finance, "Finland's Economic Growth will Remain Subdued", http://vm.fi/en/article/-/asset_publisher/suomen-talouskasvu-jaa-vaisuksi-ennustaa-valtiovarainministerio;
vm.fi/en/article/-/asset_publisher/suomen-talous-on-nopeassa kasvuvaiheessa;

Germany

Score 8

Germany's economic structure is characterized by a healthy mix of service and industrial sectors. In the five years following the reform plan "Agenda 2010" of 2003, Germany's economic policy successfully addressed numerous serious economic weaknesses prevalent in the post-unification period. This wave of reforms has affected labor market institutions, unemployment benefits, the pension system, corporate taxation, the constitutional debt brake and liberalized labor migration from outside the European Union. It has also improved Germany's competitiveness and increased its attractiveness as a destination for foreign investment. Moreover, the European sovereign debt crisis has further strengthened the country's reputation as a safe haven for financial and real investment. As a result, the German state and wider German economy currently benefits from extremely low interest rates. The ongoing employment boom, rising real wages and pensions, very low interest rates, buoyant construction investment, very strong export performance and increasing public expenditure have created almost ideal growth conditions lifting GDP growth above 2% in 2017. The chances are excellent that Germany will experience a tenth year of continuous growth in 2018 (Sachverständigenrat 2017/18). The only current downside to this situation has been the first symptoms of a cyclical overheating with job market vacancies exceeding one million and an increasing share of companies producing at total capacity.

As the result of robust economic growth and employment, the last government abandoned the liberalizing policy agenda of the first decade of the millennium in favor of greater regulation. For example, the policies of the grand coalition 2013 – 2017 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, so far, neither greater government regulation nor increased wages have undermined Germany's export performance or employment growth.

Citation:
Sachverständigenrat zur Begutachtung der Gesamtwirtschaftlichen Entwicklung (2017): Jahresgutachten 2017/2018. https://www.sachverstaendigenrat-wirtschaft.de/jahresgutachten-2017-2018.html

Latvia

Score 8

Following a difficult period of economic adjustment in 2009 and 2010, Latvia's economy has fully rebounded, returning to the international markets and to favorable economic growth rates. In 2016, Latvia's annual growth rate was 2.0%, in line with the EU average. In 2017, the growth rate is significantly rising, with the second quarter rate standing at 4.8% compared to the same period in 2016.

Latvia's economic policy had been governed by parameters accepted as part of financial assistance provided by the IMF and European Union. 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. The Fiscal Discipline Council (FDC) plays an oversight function, consulting with the government on fiscal planning issues and compliance with the budget deficit cap. In 2017, the FDC drew attention to overspending stemming from a reallocation of resources away from projected payments into the EU budget and toward the national budget; it also argued that projections for the fiscal effects of the tax reform were overly optimistic.

Since meeting its policy goal of joining the euro zone in 2014, Latvia's focus has necessarily shifted to longer-term issues of maintaining competitiveness within the euro zone and addressing social inequalities. Structural reforms are underway within the areas of education and science, health financing, 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.

Citation:
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2. Fiscal Discipline Council of the Republic of Latvia (2017). Irregularity reports (06.09.2017,15.09.2017,20.09.2017).

3. Fiscal Discipline Council of the Republic of Latvia (2017). Macroeconomic forecast endorsement (04.08.2017).

4. European Commission (2017),2017 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011. https://ec.europa.eu/info/file/96711/download_en?token=i5i9Q_FV. Last accessed 19.11.2017.

5. OECD (2017) Economic Survey of Latvia (2017). http://www.oecd.org/economy/surveys/Latvia-2017-OECD-economic-survey-overview.pdf. Last accessed 20.11.2017

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. In its 2018 Doing Business report, the World Bank ranked Lithuania 16 out of 190 countries overall. The country's position in this rating is very close to the target of 15th place set by the Skvernelis government, which formed after the parliamentary elections in late 2016. The criteria assessed most positively included registering property (ranked 3), enforcing contracts (ranked 4) and dealing with construction permits (ranked 12). Meanwhile, resolving insolvency (ranked 70) was assessed least positively. Lithuania climbed five positions in the 2018 report from 21 out of 190 countries in 2017. This is attributable to an increase in the number of indicators, including a substantial change in terms of access to electricity (ranked 55 in 2017 and 33 in 2018). In the Global Competitiveness Report 2017-2018, the World Economic Forum ranked Lithuania 41 out of 137 countries, scoring above average on higher education and training (ranked 29), macroeconomic environment (ranked 29) and technological readiness (ranked 30), but below average for market size (ranked 78). Lithuania dropped six positions in the 2017-2018 report, which is attributable to the sluggish implementation of reforms. However, the report did not take into account the adoption of the new Labor Code, which will improve the country's ranking in the area of labor market efficiency in the next report.

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 food and agricultural 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 European Union. However, Lithuanian companies managed to reorient their exports to other markets, demonstrating their flexibility. 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 and if euro zone growth continues this should drive Lithuanian exports. According to European Commission, after several years of growth rates above the EU average, Lithuania's GDP growth rate slowed to 1.7% in 2015 due to a significant drop in exports to Russia, but recovered again to reach 2.3% in 2016 and is projected to increase to 3.8% in 2017.

Although the 2008 to 2012 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 was completed by the end of 2015, with the first electricity link to Poland becoming operational in 2016. These projects are expected to provide alternative energy-supply sources, and have received significant attention. Mostly due to low prices in the Nordic countries, electricity prices in Lithuania decreased in 2016 to 2017, providing evidence of the economic benefits of additional sources of supply. Further infrastructural integration projects –

including the completion of a second electricity link to Poland, withdrawal from BRELL (Russia managed electricity grid) and construction a natural gas connection to Poland – are high on the agenda of the current government (for more on energy projects see Vilpišauskas 2017). The 2012 to 2016 government presented Lithuania's accession to the euro zone in January 2015, another major economic policy event, as a signature achievement. However, accession to the euro zone was supported by all major political parties and much of the preparation for accession had been undertaken by the previous government. The recent increase in the inflation rate in Lithuania, which has become the central public concern as evidenced by Eurobarometer surveys, has been attributed in part to the introduction of the euro. Though experts largely link the increase in inflation to Lithuania's need to catch up economically and the monetary policies of the European Central Bank.

Considerable political emphasis has been placed on structural reforms 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. However, inefficient government bureaucracy remains the second most problematic factor for doing business in the country, according to surveyed business executives. In the Global Competitiveness Report 2017-2018, the World Economic Forum ranked Lithuania 101 out of 137 countries for efficiency of the legal framework in challenging regulations and 97 for the burdens imposed by government regulation. Toward the end of its term, the 2012 to 2016 government reformed the Labor Code and social protection, including the pension system. The Labor Code came into force on 1 July 2017 after the new government altered some provisions in a search of a better balance between labor market flexibility and employee protection in the Lithuanian parliament.

Citation:
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COMMISSION STAFF WORKING DOCUMENT, country report Lithuania 2017: https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-lithuania-en.pdf
The 2017 – 2018 Global Competitiveness Report of the World Economic Forum: http://www3.weforum.org/docs/GCR2017-2018/05FullReport/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf
Standard Eurobarometer 86, Public Opinion in the EU, Autumn 2016, Brussels: European Commission 2016
Vilpišauskas, R. `The evolving agenda of energy security in the Baltic Sea Region: persistent divergences in the perception of threats and state-market relationship,' in Sprūds, A., Andžans, A. Security in the Baltic Sea Region: Realities and Prospects, Riga Conference Papers 2017, Riga: LIIA, p. 187-199

Luxembourg

Score 8

Ten years after the outbreak of the financial crisis, the financial markets regained trust and the economy strong growth. In particular for Luxembourg's exports and services, the euro zone's economic recovery has resulted in stronger GDP growth than before the crisis. The economy of the Grand Duchy is strengthening, domestic demand is increasing and the workforce is expanding. In the second quarter of 2017, GDP grew by an impressive 4%. In 2016, the real GDP growth rate was 4.2%, higher than the average euro zone growth rate and an increase of 0.2% compared to 2015 (4%).

Following learning from the crisis, the small country is now well prepared to master the challenges posed by the global market by developing long-term business synergies that take into account the future consequences of digitalization. The government is more consequently promoting start-ups and spin-offs. Luxembourg's university is growing and developing infrastructures for new research on topics such as big data. Brexit is expected to particularly benefit the country's insurance sector. Behind Dublin and Frankfurt, Luxembourg holds third place on relocations resulting from the 2016 Brexit referendum. Six financial entities have announced plans to settle in Luxembourg. The ongoing debate on tax rules and transparency will be significantly impacted by the recent U.S. corporate tax reform. 10,909 offshore companies (sc. letterboxes not engaged in any genuine or effective business, arising from 81 bilateral tax treaties) in all tax havens of the world are or were connected to Luxembourg. The deep mistrust that dominates the debate about tax avoidance can only be overcome by public disclosure and coherent supranational tax policies.

Luxembourg is a small and open economy. For some time, it has ranked highly on international competitiveness indexes. Similar to last year, Luxembourg was ranked 19th out of 140 countries in the International Institute for Management Development's index (World Economic Forum, 2017). Luxembourg also ranked highly on macroeconomic environment (7th position), goods market efficiency (4th position) and technological readiness (1st position). However, Luxembourg underperformed in higher education and training (50th position) and health and primary education (41st position), which are important drivers of economic competitiveness and job creation. Furthermore, Luxembourg airport is the 7th biggest cargo hub within Europe and is home to Europe's largest all-cargo airline Cargolux.

Since 2015, changes to EU legislation regulating VAT rates across the EU reduced Luxembourg's VAT revenue from e-commerce. Following negotiations with the European Commission, the policy will be fully implemented by 2018. In response, the government has increased general VAT rates and new business clusters have been created to generate new revenue. The 2017 tax reform implements a progressive corporate income tax (CIT) reduction from 21% to 18% in 2018.

The financial sector remains an important driver of economic growth and sustainable development. At the same time, the proportion of cross-border workers to resident workers continues to increase. To expand the national labor force, Luxembourg changed its immigration and naturalization policy in 2017 facilitating naturalization. It now only requires five years of residence (with interruptions) to naturalize. In addition, a new regulation voted on in February 2017 aims to offer investors a residence permit to set up family offices or for asset management.

Nevertheless, the country's generous welfare model must be reformed to adapt to the reality of reduced public resources. Luxembourg's long-term fiscal sustainability is moderately secure. In its evaluation of Luxembourg's Stability Program 2020, the European Commission highlighted concerns over the country's overly optimistic economic-growth outlook and its inability to address age-related expenditures and resilient growth. Furthermore, in 2017 industrial output dropped by 0.9%, indicating considerable diversification deficiencies within an economy that focuses excessively on finance and banking.

Citation:
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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, the economic planning ministry and social partners exist through the Malta Council for Economic and Social Development (MCESD). This system has provided the ideal foundation for strong economic performance. Indeed, provisional GDP estimates for the second quarter of 2017 indicate an 8.5% increase over the same period in 2016 and a 6.4% increase in real terms. Strong export growth particularly in services and a fall in imports related to a contraction in investment is pushing up the current account surplus, which is forecast to approach 10% of GDP in 2017. Real GDP growth is projected to slow somewhat in 2018 to 4.9%. Private consumption is expected to become the main driver of growth due to the increasing population and growing disposable income. Furthermore, Malta's labor market remains resilient and currently has one of the lowest unemployment rates in the EU. Current industrial legislation provides protection against dismissals and allows for open bargaining between employers and their unions, but few co-determination structures. Unit labor costs have remained moderate, but are projected to rise faster than the euro zone average in 2018 and 2019.

The latest EU forecasts project that Malta's robust economic performance will continue in 2017 and 2018, driven primarily by external demand. Investment levels remain above historical averages, while declining unemployment rates and increased disposable income have encouraged economic growth. Moody's Investors Services also confirmed Malta's A3 rating with a stable outlook in September 2017. However, the World Economic Forum's Global Competitiveness Report 2017-2018 identified the inefficiency of government bureaucracy and the insufficient capacity to innovate as the most significant obstacles to doing business in Malta. Other limitations included suboptimal infrastructure, difficulties in accessing financing and an inadequately trained workforce. Nonetheless, the country ranked 22nd in terms of technological readiness and 37th overall, which represents an improvement over the preceding reporting period where Malta ranked 40th.

The World Bank's Doing Business Report 2017 ranks Malta's ease of doing business at 76th out of 190 countries, an improvement from the preceding year's rank of 80th. This year's report notes improvements in relation to business registration with the Inland Revenue Department and improved access to credit information through the launching of a new credit registry; Malta is, however, viewed unfavorably when it comes to increased costs associated with tax and social security contributions. In an effort to reduce red tape, government has created the position of Commissioner for Simplification and Reduction of Bureaucracy with the aim of, among others, reducing the administrative burden for investors setting up businesses in Malta. A total of 500 simplification measures have been implemented over a period of five years. The government has stated that it is working to make the islands a center of excellence for block chain technology, which it believes will be the leading engine for growth in the future.

Rapid economic growth has brought to the fore several challenges. First, the continued dependence on financial services and property development along with the widening trade deficit in 2017 highlight the need to further diversify the economy. Second, this growth has depended on massive building programs and the import of labor, while also increased demands on infrastructure and social services to a degree unsustainable for an island country that measures 316 square kilometers.

Citation:
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Times of Malta 31/05/2017 Malta's jobless rate remains among EU's lowest
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European Economic Forecast Spring 2017 p.96
https://www.moodys.com/credit-ratings/Malta-Government-of-credit-rating-6000129477
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Doing Business – Equal Opportunities for All (Economy Profile 2017 Malta) p.6
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https://simplification.gov.mt/en/Pages/home.aspx
The Malta Independent 05/04/2017 Government implements 500 simplification measures over a period of three years
Times of Malta 11/09/2017 Trade deficit widens by €100m in July
European Commission Autumn 2017 Economic Forecast - Malta

Spain

Score 8

Spain's economic recovery continued in 2017, with the economy expanding again by 3%. This means that the economic recovery begun in 2014 remains robust. The economic growth is also much higher than that observed in other euro zone economies such as Germany (2.2%), France (1.8%) and Italy (1.6%) in 2017. After reforms to the banking sector and labor market, unit labor costs fell significantly and productivity rose. In 2017, the competitiveness gains continued to support exports, despite the strength of the euro. The European Commission's decision to grant more flexibility for meeting fiscal targets and euro area monetary policy was also helpful as were the decline in oil prices and arrival of nearly 80 million tourists.

The recovery has also been driven by domestic demand. Notwithstanding, the Spanish economy has not yet rebounded to 2008 levels. Income per household remains lower than in pre-crisis times and bank lending remains limited. Households have reduced their debt by nearly 55% of GDP since mid-2010. However, the public deficit is high (forcing the continuation of fiscal austerity policies), inequality is severe, and unemployment rates, while decreasing, remain at a very high level (16.5% in 2017). Also, political tensions in Catalonia increased uncertainty in the second half of 2017 as well as significantly lowered consumer and business confidence and investments.

Citation:
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https://ec.europa.eu/info/sites/i nfo/files/09_es_sp_assessment.pdf

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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. The positive trajectory of economic development has continued in recent years.

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.

Most indicators suggest that the economy is doing quite well; the finance ministry expects GDP growth in 2017 to be 3.1% and 2.5% in 2018. However, there are some challenges. 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, then to -0.35% in September 2015. By November 2016, the interest rate had fallen to -0.5%.

Another concern is household debt, which continues to increase. There are also growing fears (as mentioned in an IMF report) of an emerging bubble in the real-estate market. In an attempt to cool the market, the government has introduced mandatory mortgage repayment rules, and there is some discussion on phasing out tax deductions for interest rate payments. Together with increasing construction, these measures would help cool off the real-estate market in metropolitan regions in the longer term. However, the current housing shortage in metropolitan areas that is driving real-estate prices up increases the short-term risk of a bubble in the real-estate market. In November 2017, the government announced plans to introduce a mortgage requirement beginning in 2018 (the exact date is yet to be decided) to help cool the real-estate market and curb household debt.

Economic growth and international competitiveness are closely linked to unemployment and the dynamics of the labor market. The red-green government is committed to halving the country’s unemployment rate (which is already one of Europe’s lowest) by 2020; a target which will be difficult to reach, given the current refugee crisis in Europe. Unemployment decreased somewhat in 2015 and early 2016. However, 2017 and 2018 will prove more challenging as the large numbers of immigrants will register as unemployed in early 2017 after completing Swedish language training programs.

Perhaps even more troubling, there are now signs on both sides of the political aisle that policymakers might relax their commitment to the regulatory framework that has to date shaped public budgets and the 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. In 2016, the Social Democratic and Green government negotiated with opposition parties to introduce a reform of the financial framework. The revised framework retains the surplus goal, but at a lowered 0.33% over a business cycle. More importantly, the revised framework states that public debt is to be brought down incrementally.

Moreover, some sectors of the economy, for example the housing market, suffer from low efficiency and lack of transparency. In addition, tax reforms implemented before the last period under review have further undermined economic equality. Nonetheless, Sweden’s economy and its regulation thereof are generally considered to be efficient and sound. Whether this is a product of policy incentives, or a consequence of being outside the euro zone is a matter debated among economic experts.

Although the institutional and regulatory framework of economic policy remains overall 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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Switzerland

Score 8

The Swiss economy is highly competitive, ranking again at the top in the World Economic Forum's 2017 competitiveness assessment. The country's economic policy regime combines a variety of mechanisms. Common denominators, however, are the practice of muddling-through as standard operating procedure and heterodoxy as the primary philosophy underlying economic policymaking.

For example, regulation of the labor market is very liberal, particularly with regard to hiring and firing. In contrast, government policies were quite illiberal and politicized with regard to the flow of foreign labor and with regard to farming in the past. The policymaking process previously emphasized the integration of employers and trade unions, with employers enjoying considerable influence ("liberal corporatism") and trade unions serving as junior partners. For trade unions, this corporatism made sense since it resulted in full employment (at least for Swiss citizens), high wages and generous employer-sponsored benefits. While this influence was strong in the past, in recent years the influence of both organized labor and capital has lessened.

Throughout the 20th century, Switzerland maintained a very protectionist policy regime, allowing for cartels and monopolies. The main beneficiaries were farmers, who were protected from global 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. Collusive pricing was tolerated, while competition between providers and producers was limited by the diversity of cantonal regulations.

This policy of protectionism has lessened considerably since the mid-2000s due to a deliberate strategy of market liberalization. At the same time, there has been continuous pushback to this liberalization. For example, an amendment to the law on cartels failed. It would have reduced the influence of major economic actors within the competition agency's governing board. Similarly, in farmers were successful in being spared from austerity measures; they continue to enjoy a comparatively high level of protection. In 2017, under pressure from the WTO, the government presented a plan to abolish subsidies for certain exported agricultural products. At the same time, the administration suggested new subsidies for the agricultural sector, which would compensate farmers for losses incurred due to the new WTO-compatible regulation.

Between 1960 and 2005, Swiss real GDP growth rates have exceeded the average of the 23 advanced-democratic OECD nations in only nine of 44 years. Since 2005, Swiss economic growth rates have been above average – except in 2014 and 2015. Some economists have attributed the Swiss economy's strong growth since about 2005 to its liberalizing reforms. Others note that most of the increase in domestic product is not due to higher productivity, 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). With very few exceptions, Switzerland's current account balance has been positive since the 1970s, implying that exports exceed imports. Switzerland's main export industries are the chemical, pharmaceutical and metal industries. A considerable share of recent economic growth is therefore export-driven, making Switzerland very dependent on export markets. The country's increasingly rocky relationship with the European Union poses imminent dangers to the continued success of its export-oriented economy. However, Swiss economic growth is very robust. Although the Swiss franc appreciated considerably following the decision of the Swiss National Bank to abandon the peg to the euro in January 2015, while the effect on the national economy has been limited with few repercussions.

The government levies low taxes on both labor and capital, producing relatively small tax wedges. In addition, the state does not significantly intervene in the business cycle. Rather, it traditionally pursued a prudent and largely procyclical fiscal policy. In times of major economic challenges, 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 and proved difficult to implement swiftly. In fact, many of the resources contained in these fiscal programs have not been taken up by employers. 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.

Rather than actively influencing the structure of industry, the government has restricted itself to facilitating the modernization of industries by creating favorable conditions for economic activity. In the financial industry, Switzerland has improved its surveillance of banks and set prudential banking regulations since the onset of the "great recession" in 2008.

In general, decision makers have pursued a very pragmatic and heterodox economic policy and shown themselves willing to disregard liberal norms of policymaking if the need arises. This policy regime, which has been both liberal and protectionist, has come under pressure due to globalization and the increasing importance of international organizations such as the WTO. Given its reliance on the export of goods and services, Switzerland has had to acquiesce to liberalization.

Liberalization was accelerated by bilateral treaties with the European Union and practically all new economic policies have followed EU standards. As a consequence of globalization and Europeanization, most sectors increasingly liberalized, in particular in the period between the mid-1990s and 2005. Agriculture offers a major case in point, though Switzerland's agriculture sector remains one of the most subsidized in Europe.

As a result of liberalization, one of the drivers of Switzerland's postwar economic success – the complementarity of protected domestic-oriented industries and liberal export-oriented industries – has been weakened. The increase in tensions between the export- and domestic-oriented sectors have generally not resulted in open conflict. These developments have, however, 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 and their members have increasingly turned to lobbying at the level of the individual firm.

Switzerland has not yet determined its long-term relationship with the European Union. In the current review period, the quest for politically and economically sustainable solutions became more pressing. Previous interventions entailed bilateral agreements with the European Union, which further liberalized the service and agriculture sectors. In addition, immigration policy has changed substantially. Switzerland has abstained from any further recruitment of foreign labor from outside the European Union, while liberalizing its immigration regime with EU countries. This policy has meant free movement of labor between Switzerland and the European Union, intensifying opposition to the recruitment of highly skilled employees from abroad.

This bilateral arrangement with the European Union faces major challenges. The European Union has requested new institutional structures to complement and support the bilateral relationship. It argues that the implementation and update of bilateral agreements has become too costly as a result of delays generated by domestic conflicts. Specifically, the European Union has insisted on the creation of independent authorities for the settlement of disputes as well as mechanisms for updating bilateral agreements without having to resort to full-scale renegotiations. As of fall 2017, no new institutional arrangements have been established and the domestic political opposition has gained strength. Given the country's close integration with the EU market – accounting for 54% of Swiss exports and 72% of imports (2016) – Switzerland is highly dependent on a well-functioning relationship with this much larger economic partner. In contrast, the European Union is much less dependent on Switzerland.

Broadly perceived as a laggard in the development of its welfare state, Switzerland caught up in the postwar period. Today it has a mature and generous welfare state. In a time of demographic change, this welfare state will only remain 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 European Union is constrained.

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 then endured a deep recession during the financial crisis before recovering from 2013 onwards, despite weak demand from the euro zone, the United Kingdom's largest export market. There are concerns that the economy is too reliant on consumers' expenditure, fueled by overly high household debt and sustained by very loose monetary policy.

The change in government in 2010 led to the adoption of an economic policy framework ostensibly focused on budgetary consolidation, but there has been a substantial watering down of the fiscal rules put in place by previous governments; targets for returning to fiscal balance have repeatedly been pushed to later dates. This has meant the squeeze on public spending has been less than is often claimed because the government also chose to protect key areas of public services, 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. Insufficient public investment is reflected in creaking infrastructure and skills shortages.

The economy initially appeared to shake off the political shock of the "leave" vote in the June 2016 EU referendum, with the fall in the exchange rate helping to absorb the shock. In 2017, however, economic growth slowed such that the United Kingdom shifted from being one of the most rapidly growing mature western economies to one of the slowest. The labor market has remained buoyant, with the number of people in work reaching another all-time high at 32.08 million toward the end of 2017. This labor-market performance partly reflects a job-friendly economic policy, but nominal wages have not kept pace with inflation, leading to falling real incomes. Moreover, disappointing productivity figures have led the independent Office of Budget Responsibility to reduce its estimate for the long-term growth potential of the economy. The current account deficit decreased to 4.6% of the GDP in the second quarter of 2017 somewhat lower than in previous years, up however by 0.2% compared to the first quarter of 2017. This is indicative of the continuing export weakness of the UK economy. Uncertainty about future UK-EU relations and threats to the future access of UK financial services to the continental market are weighing on the economy.

Citation:
http://obr.uk/efo/economic-fiscal-outlook-november-2017/

United States

Score 8

Considered over any extended period of time, 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. International financial markets have not punished the United States for long-term budget deficits that would have adversely affected other countries. Although its pro-business 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.

Although the Trump presidency began in January 2017, only two months into the assessment period, President Obama's economic policies (as constrained by Republican opposition in Congress) remained in effect and without major alteration for most of 2017. The United States thus continued a moderately expansionary fiscal policy with the Federal Reserve Board maintaining steady, comparatively low interest rates. The moderately strong economic growth established during the Obama administration continued through Trump's first year. In every agency where Trump has nominated the senior policy official, the need for new regulation – and the value of old ones – is being questioned. Both Treasury reports emphasized deregulating the economy through administrative action, which is clearly the most likely route to reform. Without the specter of new regulations adding to their costs, the business community is recognizing that they can plan for growth. As a consequence, the markets have been exuberant in the first year of the Trump administration.

During the year, Trump and the Republicans failed in efforts to pass a major infrastructure program, and to "repeal and replace" the 2010 Affordable Care Act (Obamacare), leaving domestic spending relatively constant. Expectations of major tax cuts, focused largely on corporations and high-income taxpayers, helped sustain a buoyant stock market. The United States pulled out of the Trans-Pacific Partnership trade agreement. Increased uncertainties about trade relationships and expected increases in long-term deficits have had negative implications for long-term economic growth.

Austria

Score 7

The Austrian economy has remained in the general European context. The economic upswing – expressed in economic growth and, at last, lower unemployment – has affected Austria. Austrian politics has not prevented that general trend from benefiting the Austrian economy. Nevertheless, more significant steps towards reform – especially concerning the labor market – have been discussed, but are not yet or not fully implemented. A significant part of the relative 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.

At the end of 2017, a new Austrian government will be formed without the Social Democrats who continue to dominate organized labor. The new center-right government may have an impact on the balance of Austria's social partnership. The national-liberal FPÖ, in coalition with the conservative ÖVP, intends to weaken the main chambers (business, labor, agriculture) by weakening or abolishing obligatory membership laws. This will provoke a reaction from the chamber of labor, united with the ÖGB (Austrian Trade Union Federation) – which will include labor conflicts – as well as the chamber(s) of commerce.

The Austrian export industry has contributed significantly to the country's overall success. Austria's economy has profited from the inclusion of former communist, central and eastern European countries in 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. The Austrian finance (banks, insurance) and construction industries play an important role in the four Visegrád countries and in most former Yugoslav republics.

A process of fiscal consolidation is currently underway, with the goal of keeping the government deficit below 3% of GDP. Other programs include a restructuring of the Austrian banking system to reduce risks to the national economy. Future burdens may arise from the ever-more-significant redistribution of resources to people aged over 50 (to the disadvantage of 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. The parties of the new government (ÖVP, FPÖ) aim to achieve in the foreseeable future a zero deficit.

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 euro zone, only Germany has a more unequal distribution of property.

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

Belgium

Score 7

Located at the heart of the euro area and the European Union, Belgium is a small, open and competitive economy. Its performance depends as much on the actions of its federal and local governments as on the general economic climate of the euro area. The adjustments initiated in the wake of the economic crisis have restrained economic growth for several years, but substantial improvements on that front are now evident.

The high degree of exposure to global competition forces governments to keep an eye on the country's international competitiveness, with mixed results. Belgium's competitiveness eroded over the last decade, with production costs and market distortions progressively worsening in comparison with those of immediate neighbors. This resulted in erosions of the country's export share within world markets. To compensate, the country offered increasingly generous tax deals to multinational enterprises. As these have recently been criticized as illegal state aid, the Michel government initiated a set of structural and tax reforms meant to 1) reduce the inflation gap (unfortunately focusing more on wage-cost cuts than on product-market structural reforms), 2) partially remedy the labor-tax distortions that contribute to the competitiveness handicap and 3) reduce corporate taxation across the board – this latter policy being a recent development not initially planned by the government.

These efforts essentially represent the positive side of current efforts. On the negative side, we can identify: 1) structurally low levels of public infrastructure investment (as much as a full GDP point below levels in France and the Netherlands – see the WEF's competitiveness report and/or the OECD's economic survey of

Belgium); 2) employment rates that remain consistently low as compared to the OECD average, especially among youth; 3) low levels of GDP per hour worked in comparison to the OECD average; and 4) chronic underfunding of the higher-education sector, meaning that Belgium's once-strong position in terms of worker skills is likely to continue eroding.

Another major challenge hindering international competitiveness is the relatively low level of entrepreneurship, which hinders the market entry of young, innovative firms. In addition, the government is unusually right-wing for a country with a tradition of middle-of-the-road coalition governments. The current government's heavy-handed reform style has provoked substantial opposition and political unrest (e.g., demonstrations and strikes) that has done little to contribute to the investment climate.

Citation:
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Chile

Score 7

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. As studies by Chile´s central bank indicate, economic growth increased between 1.25% and

1.75% during the period under review. Slightly higher growth is expected for 2018. With about 6.9%, the unemployment rate stayed stable in comparison with the previous period under review, but still at a relatively high level considering the past 10 years.

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 primarily depend on the export of commodities such as copper, agricultural and silvicultural products with relatively low added value. Thus, Chile shows a comparatively 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 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.

Citation:
Informe Política Monetaria del Banco Central
http://www.bcentral.cl

Instituto Nacional de Estadística
http://www.ine.cl

Czech Republic

Score 7

The Czech economy is among the fastest growing in Europe, with real GDP up by more than 4% in 2017 relative to 2016. This acceleration was due to strong export performance, especially for motor vehicles, and high consumer spending driven by higher earnings. This partly reflects labor market conditions and partly a policy shift away from an emphasis on holding down pay increases. In the past, economic policy in the Czech Republic largely focused on balancing the budget and attracting incoming FDI through low wages. As the limits to this strategy have increasingly become visible, the focus of the Sobotka government shifted away from wage restraint and toward investment in education and R&D and the development of an environment for innovative activities within the domestic economy. In practice, however, improvements in these areas appear inadequate and have depended on EU funding. The latter has overtaken inward private investment as a major stimulus to growth, accounting for almost half of recent GDP growth. A further important change in the economic policy framework has stemmed from the Czech National Bank’s decision in April 2017 to end the commitment made in November 2013 to keep a low exchange rate of 27 Kc to the euro. The aim had been to counter the perceived threat of deflation by increasing import prices. Free to find its own level, the Kc floated upwards, holding back the level of inflation which rose slightly above the central bank's target level of 2% per annum in 2017.

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. Its two central objectives are the increase of productivity and employment. The implementation 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 prospective need for labor, the Ministry of Education implements initial and in-service training policy, and the Ministry of Social Affairs is responsible for employment policy. Additionally, due to growing labor shortages, the Ministry of Interior, responsible for immigration, has also become an important actor in economic policy. The Ministry of Economic Affairs holds the overall responsibility for the development and implementation for 13 strategic documents, which suggests that fragmentation and duplication of priorities is a continuous issue.

The global economic climate has been quite optimistic in the period under review. This trend is echoed in improved performance of the national economy. Yet, high tax rates on labor and strict immigration policies are major obstacles to attracting the foreign labor urgently required as a consequence of Estonia's aging population.

Iceland

Score 7

Nine years after the 2008 economic collapse, Iceland's economic policy has still not escaped from the fallout. Even if the capital controls imposed to stabilize the Icelandic króna following the financial crash were for the most part rescinded in 2017, the economy still feels the pinch of the harsh fiscal adjustment strategy, which imposed a retrenchment equivalent to about 10% of GDP between 2010 and 2017. The fiscal adjustment strategy meant that important public services were seriously underfunded as a result, especially health care and education. The relaxation of foreign exchange controls is almost complete. A novel, perhaps lasting part of the relaxation scheme involves an arrangement in the spirit of the Tobin tax. This arrangement requires foreign speculators – who want to benefit from higher interest rates in Iceland than abroad through carry trade – to place a certain portion of their deposits in special accounts that are tied for a certain period. The aim is to reduce short-term fluctuations in capital flows. This seems to have worked well thus far. Moreover, restrictions still apply to derivatives trading for purposes other than hedging and cross-border foreign exchange transactions not intermediated by a financial undertaking as well as certain foreign currency lending by residents to nonresidents. The relaxation was orderly and was not followed by a sudden outflux of capital or depreciation of the króna.

The Icelandic króna strengthened by 8% vis-à-vis the U.S. dollar during 2017 (i.e., during the period under review from November 2016 to November 2017), while remaining essentially unchanged vis-à-vis the euro. This followed the significant strengthening of the króna against both currencies during 2016 due to strong foreign exchange earnings from tourism, and the return of funds to Iceland that had fled the country before and during the financial collapse of 2008. During 2012-2015, the central bank held several auctions at which holders of offshore currency were invited to bring their money back to Iceland at a discounted exchange rate. It has been reported that several jailed bankers were among those who took advantage of these controversial central bank auctions. Tight fiscal and monetary policies remained in place during 2017, underpinning low inflation accompanied by full employment. Contrary to central bank and IMF projections, inflation remained below 2% during 2017. Even so, employers blame labor unrest, including strikes, for encouraging wage increases that threaten to cause an overall increase in prices. During 2018, a new round of general wage negotiations will take place against the background of substantial wage increases recently granted by the Wage Council to members of parliament, senior public officials and the president of Iceland. Though the president refused to accept the salary increase and donated it to charity.

Following the 2008 economic collapse, the government sought to strengthen the Financial Supervisory Authority (Fjármálaeftirlitið, FME). The FME had performed before the collapse in 2008 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 2017, the efforts of the FME and the special prosecutor had led to the successful prosecution of 35 individuals for legal violations connected to the 2008 crash. The Supreme Court sentenced these individuals to a total of 88 years in prison, equivalent to about 2.5 years per convict on average. The Office of the Special Prosecutor was abolished in 2016 and merged with the Office of the District Prosecutor under the directorship of the former special prosecutor.

The future of the banking sector remains uncertain. The government has not yet presented any concrete plans for restructuring the banks. At the time of writing, the government still owned a majority stake in one of Iceland’s three largest banks, Landsbanki, while creditors of the other two failed banks and foreign venture funds own substantial majority stakes in the other two banks, Arion Banki and Islandsbanki, that replaced the failed Kaupthing and Glitnir. 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 preceding 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 government's coalition partners at that time, the application process was put on hold in January 2013. In 2013, the government expressed its intention to unilaterally retract Iceland's membership application. A formal withdrawal was announced in the spring 2015. However, the European Union and the Icelandic government seem to disagree on whether this means that Iceland has fully withdrawn from the process. Specifically, the European Union has questioned the authority of Iceland's foreign minister to unilaterally withdraw an application approved by parliament. This question is most likely going to remain unanswered for some time.

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Israel

Score 7

In general, while Israel's economic policy has some shortcomings, it is fundamentally strong. It largely provides for a reliable economic environment, renders the country internationally competitive and ensures it remains attractive as a location for economic activity.

According to the OECD, Israel's economy is expected to grow by 3.5% in 2018 and 3.3% in 2019. Economic results in 2017 were generally good, but not as strong as in 2016. The economic growth rate of 3% in 2017 was down by 1 percentage point from 2016's 4% growth rate. The inflation rate in 2017 was 0.4%, up from the negative inflation of 2014 – 2016. In addition, the general employment rate of 77% in July 2017 (among the population aged 25 to 64) remains one of the highest in the western world. The budget deficit has declined in recent years, from 3.9% in 2012 to 2.2% in 2017. While Israel's growth rates have improved over the last decade, productivity performance has been weak. As the OECD economy survey states, “highly dynamic tradable goods industries coexist with an inefficient sheltered sector to an unusual extent, dragging down overall economic performance.” Product-market regulation and competition, particularly in the food, banking and electricity sectors, has undermined economic productivity.

In addition, poverty rates are still high, especially among the elderly. Income inequality ratios are also high. According to recent data, 1,809,000 people in 463,000 families were living in poverty in 2016, including 842,300 children. Although the incidence of poverty declined from 19.1% in 2015 to 18.6% in 2016, Israel has the highest poverty rate within the OECD. The cost of living also remains high, particularly for housing. Housing and rental prices have clearly increased in recent years, although the rate of growth declined in 2017. This trend mostly affects the middle and lower classes, and was one of the main causes of the 2011 social-justice protest.

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Italy

Score 7

During the period under review, the Gentiloni government pursued an economic policy agenda oriented to driving economic recovery. During 2016, economy recovery started to build momentum and has accelerated through 2017. The government’s fiscal policy has had to follow a careful path between respect for the euro zone’s rules and support for the domestic economy. Using some of the budgetary flexibility granted by the European Union, the government has prolonged the expansionary measures of previous years (e.g., the €80 monthly tax credit and the reduction of business taxes) and has added significant incentives for innovative investments in industry (the so-called Industry 4.0 program). The policies of the government have also encouraged public investment by local authorities, which in previous years had been severely constrained by the internal stability pact. Though public investment in industry remains seriously below required levels. The costs of employing young people have been reduced and measures to tackle poverty have been strengthened. Efforts to further reduce inefficiencies in state expenditure were continued by the spending review.

Norway

Score 7

The decline in oil prices has affected the Norwegian economy, with the sharp fall in prices over the last two years creating a strong impact. The economy is in transition and greater emphasis is being placed on diversification to reduce dependence on oil and gas revenues. The economy has been struggling with reduced investments in the offshore industry, with the implications being felt across the economy. Yet, as prices have started to increase, activity picked up again in 2017. There are growing concerns that rising housing prices and private debt levels will pose a challenge if interest rates increase.

The economy remains strong. 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 has increased in the country’s western region, which is most affected by reduced activity in the petroleum sector. The management of petroleum revenues – which are used domestically with prudence and otherwise invested abroad through a sovereign fund focused on equity, bonds and property assets – is held in high regard by international standards.

The state wields 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, although costs have dropped significantly. 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.

Citation:
I see no sign that the economy has improved. Therefore I do not change the score.

Poland

Score 7

The Polish economy is still on a strong footing. With real GDP up by about 4.6% in 2017, it has continued to grow well above the EU average. Boosted by a strong increase in social transfers, improving labor market conditions, low lending rates and low inflation, it is still largely driven by the growth of personal consumption. By contrast, uncertainty over the PiS government's economic policy and the general development of the country has led to a decline in private investment, denounced by PiS chairman Jarosław Kaczyński as a deliberate attempt to weaken the PiS government by the part of the business community allegedly connected to the former government. At the same time, the government has interpreted the strong increase in outward investment of Polish firms as a sign that the Polish economy is maturing. In order to compensate for the decline in private investment, the government, within the framework of its Strategy for Responsible Development, has expanded its own investment programs and increased the utilization of EU funds.

Citation:
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Portugal

Score 7

With regard to economic policy, the Costa government has maintained its strategy of gradually reversing past austerity measures without generating adverse impacts on budgetary policy or the country's overall fiscal consolidation. It has also sought to facilitate investment through the SIMPLEX+ program, which aims to simplify bureaucratic processes.

The continuation of the previous period’s strategy has helped foster a more reliable economic environment during the period here under analysis.

The economy grew during the period under review. Quarterly economic-growth rates for 2016 were 1% in the first quarter, 1.1% in the second quarter, and 1.5% in the third quarter. Eurostat has provided a provisional estimate for overall annual growth of 1.5%.

This marks the third consecutive year of economic growth after three years of downturn from 2011 to 2013. However, just as in 2014 and 2015, economic growth in Portugal during the review period was slightly below both the EU-28 and the euro zone average. Moreover, and more worrying, economic growth slowed relative to 2015, with the 2016 rate about 0.3 percentage points lower than that of the previous year. Evidence from 2017 as of the time of writing suggested a further continuation of this pattern. In the first quarter of 2017, GDP growth stood at 1%, well above the EU and euro zone averages. However, the rate for the second quarter of 2017 was just 0.2%, below the benchmark averages.

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Bulgaria

Score 6

Macroeconomically, the performance of the Bulgarian economy is visibly improving, with economic growth increasing and unemployment falling consistently over the last three years. The monetary regime (which is a currency board arrangement) and the government’s fiscal program have both performed reasonably. Despite these favorable developments, the European Commission continues to consider Bulgaria as featuring excessive macroeconomic imbalances. This contrast can be attributed to the fact that Bulgaria is a relatively poor economy integrating and catching up to a highly developed common market such as the European Union. While this process is bound to generate temporary or even persistent imbalances, this does not necessarily mean that the process is unsustainable.

Microeconomically, the business environment in Bulgaria continues to lag behind the business environment in neighboring countries and the economy attracts very little foreign investment with a tendency for Bulgarians to export capital abroad. This can be attributed to high administrative burdens, a legal system that often fails to protect property rights and enforce contracts, and significant skills mismatches in the labor market. With the exception of education, no significant structural reforms were launched in 2017.

Citation:
European Commission (2018): Country Report Bulgaria 2018 including an In-Depth Review on the prevention and correction of macroeconomic imbalances. SWD(2018) 201 final, Brussels (https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-bulgaria-en.pdf).

France

Score 6

France’s economic outlook is improving. 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 have characterized President Hollande’s term (2012 – 2017). Three major changes explain the recent improvements. First, the international environment has improved in recent years. Second, some of Hollande’s policies, such as the attempt to improve companies’ competitiveness by reducing their tax burden, have begun to take effect. Third, the election of Emmanuel Macron in May 2017 on a liberal and pro-EU platform has radically changed both expectations and the policy agenda.

The new president and his administration have launched an ambitious reform agenda. The first step was completed by the end of September 2017 with the publication of ordinances (executive orders) reforming substantial parts of the labor law code.

In parallel, the draft 2018 budget (currently under discussion) proposes major changes, such as lowering company tax rates, abolishing local taxes on housing for 80% of taxpayers, substantially cutting social taxes paid by employees, and transforming the wealth tax into a much more modest tax on real estate assets for more wealthy owners and a flat-rate tax (30%) on capital gains. The overall philosophy is to increase the net income of low-income employees and workers, avoid capital flight and increase incentives for investors.

These structural measures need time to take effect. In the short run, the economic situation will remain rather poor, in spite of higher economic growth (1.8% forecast in 2017), with a high unemployment rate and rising public debt. However, a major effort has been made to respect EU obligations (e.g., the Stability and Growth Pact). The overall budget deficit should be below the 3% ceiling for the first time in many years.

Citation:
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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. The demand for a return to growth became more insistent after the National government took office in 2008, with some blaming the minority nature of the National 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. This is not to ignore the wider context of the global 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. According to the 2017 OECD Economic Survey of New Zealand, economic growth has averaged around 3% over the past three years and is projected to remain strong through 2018. Whereas inflation increased somewhat to 2.2 % in early 2017, it then slowed down to 1.7% in the second quarter of the same year.

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Slovakia

Score 6

With real GDP growing by almost 3.5% in 2016 and 2017, the Slovak economy remains among the strongest growing EU and OECD countries in the period under review. For 2018 and 2019, even higher growth rates are expected. Growth continues to be driven by household spending growth and net exports. After the sharp decline of public investment in 2016, overall investment is set to return to growth in 2017 and supposed to accelerate further in 2018. The British carmaker Jaguar Land Rover (JLR) with whom the Slovak government signed a major agreement in December

2015 plans to launch its production by the end of 2018. The plant to be constructed near Nitra is a €1.4 billion project providing work to more than 1,000 people. A further car company, the Chinese producer of e-cars Zhi Dou, is interested in investing in Slovakia. These developments strengthen Slovakia's position as the world's largest producer of cars per capita, but will further increase the already-high dependence of the Slovak economy on a single sector and on export performance. Moreover, long-term growth prospects still suffer from weak infrastructure, a lack of skilled labor, low R&D spending and deficits in public governance.

Citation:
European Commission (2018): Country Report Slovakia 2018. SWD(2018) 223 final. Brussels (https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-slovakia-en.pdf).

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Slovenia

Score 6

The Slovenian economy has been growing robustly since 2014, registering an annual GDP growth rate of about 2.8% for the years from 2014 to 2016 and an expected growth rate of more than 4% in 2017. While Slovenia's export performance has remained strong, as evidenced by a current account surplus of about 5% of GDP, the economic recovery has become broader-based as private consumption growth has accelerated thanks to an improving labor market, rising consumer confidence and low energy prices. In addition, public investment in infrastructure projects co-funded by the EU, mostly on the municipal level, have helped to boost growth, and private investment has shown signs of recovery. In 2017, the government paved the ground for two major investment projects, the construction of a huge paint shop near Maribor by the Austro-Canadian automotive giant Magna and the construction of a second railway track between Divača and the port of Koper. However, both projects were controversial. While Magna received large subsidies and almost unconditional support from the government for its investment, it failed to exercise transparency in managing the project and to honor initial job promises. The railway project was likewise criticized for being miscalculated and prone to corruption. In late September 2017, however, a majority of voters backed the project in a referendum, allowing the government to continue with the project. Concerns about the reliability of economic policy have been raised by the limited implementation of the privatization program presented in 2015. The planned sale of 20 companies has progressed slowly. The privatization of the country's biggest bank Nova Ljubljanska Bank (NLB) was once more postpoined in May 2017, prompting Minister of Finance Mateja Vraničar Erman to offer her resignation.

Citation:
European Commission (2018): Country Report Slovenia 2018 Including an In-Depth Review on the prevention and correction of macroeconomic imbalances. SWD(2018) 222 final, Brussels (https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-slovenia-en.pdf).

OECD (2017): Economic Survey Slovenia. Paris (www.oecd.org/eco/surveys/economic-survey-slovenia.htm).

South Korea

Score 6

South Korea has shown higher growth rates than the OECD average, with annual GDP growth of 2.6% in 2015 and 2.8% in 2016. Nonetheless, the country is struggling to adjust to a lower-growth environment. The Moon administration has taken steps to reduce the country's dependence on exports. The Moon government's cornerstone economic initiative is the "people-centered economy," which focuses on job creation, income-driven growth and welfare expansion. Key initiatives include the transition of precarious job contracts into permanent positions and a gradual increase in the minimum wage. In July 2017, the parliament passed a supplementary budget of KRW 11 trillion; however, in a break from previous governments' policies, the Moon administration has shifted the focus of fiscal-stimulus efforts to creating social-service jobs and improving the welfare system. The government has also promised to reform the country's business environment by reforming the dominant business conglomerates (chaebol), although few concrete plans have emerged. At the time of writing, the primary focus was on "self-regulation" by the chaebol. The Bank of Korea has kept its benchmark interest rate at a record low of 1.25%, although it is expected that the new government will exercise less pressure on the central bank than its predecessors to keep interest rates low. The level of household debt remains a major economic problem, and the government has implemented various comparatively modest measures aimed at cooling down the real-estate sector. With the country still overly dependent on exports for economic growth, further shadows have been cast by the North Korea crisis, the economic sanctions imposed by China following the installment of a U.S. missile-defense system (the Terminal High Altitude Area Defense (THAAD) system) in South Korea, and U.S. President Trump's attempt to renegotiate the Korea-U.S. free trade agreement.

Citation:
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Mexico

Score 5

Economic and financial stability in the last decade represents a real achievement given the frequency and depth of macroeconomic crises in the 1980s and 1990s. 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. However, inflation rates increased as the November 2017 resignation of the central bank governor, Agustin Carstens, brought uncertainty about the future of monetary policy in the country.

Investors regained confidence in the Bank as Alejandro Diaz de Leon, an economist with a long and reputable career at the bank, was named as Carstens's successor. Diaz is expected to continue Carstens's policies and both the private and public sectors welcomed his designation. The challenge for the new Bank's administration is to control an inflation rate that has just begun to slow down after a 6-year high. The phasing out of gasoline subsidies, and the subsequent liberalization of prices since 2016, raised concerns about inflation in 2017. From November 2016 to November 2017 the index of consumer prices increased 6.63%. This is possibly the combined effect of the exchange rate fluctuations and the increased prices of gasoline.

Mexico has the OECD's lowest tax-to-GDP ratio. For decades, low fiscal capacity was compensated for with oil revenues. The 2014 tax reform aimed to reduce the country's dependency on oil revenues by cutting expenditures and raising non-oil revenues. The public debt proposed in the reform, however, assumed an ambitious GDP growth rate that did not materialize. Furthermore, it contemplated an increase in oil prices to compensate for any revenues not collected. While this was a reasonable assumption at the time of the reform, it did not accomplish the goal of increasing fiscal autonomy from oil revenue and contributed to increasing the debt-to-GDP ratio. This year, the government debt reached 53.3% of GDP.

The fall in international oil prices and increasing uncertainty about the future of economic relations with its northern neighbor largely explain Mexico's GDP growth deceleration in the past year as well as national and international organizations' downward revision of economic growth forecasts. Donald Trump's election motivated a renegotiation of the North American Free Trade Agreement (NAFTA). So far, the negotiation rounds have not resulted in an overall reorganization of the agreement, but there is uncertainty about particular issues. These include the U.S. government demand for increasing the participation of U.S. companies in the provision of components for manufacturing and the inclusion of an article stipulating the automatic end of the agreement. This context has further increased uncertainty among investors and workers in both the U.S. and Mexico.

Despite ongoing reforms geared toward boosting productivity, the microeconomic picture is less positive. The economy lacks competition in key domestic sectors. Mexico remains a low-skilled, export-oriented economy tied to the North American market. The uneven distribution of income is among the worst in the OECD; despite sound macroeconomic reforms, inequality was not reduced in 2017. High levels of corruption and violence are also severe impediments to inclusive economic development.

Citation:
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Australia

Score 4

Australia's economy remained relatively weak through the year-long period to 8 November 2017. GDP growth was well below the long-term trend, while real household disposable income per capita remained stagnant, currently 1% below its 2012 level. The economy has struggled to adapt to the end of the mining boom, when record-high commodity prices delivered substantial growth in national income. The end of the boom has seen a decline in tax revenue as a share of GDP, resulting in a succession of substantial budget deficits since 2009. A lack of microeconomic and tax reforms over the last decade has also contributed to the recent slowdown in economic growth.

The end of the mining boom has resulted in a void: Australia needs to reinvent itself, but does not know how. Prime Minister Turnbull's calls for increased technological capacity remains vague. The end of car manufacturing in Australia has resulted in a loss of well-paid industry jobs.

During the review period, the Liberal-National coalition government finally accepted that to secure the passage of budget measures through the senate, revenue measures are required in addition to expenditure measures to restore budget balance. The May 2017 budget therefore saw a more balanced mix of expenditure cuts and tax increases than had been attempted unsuccessfully in previous years.

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. Prior to the 2016 meeting of the Council of Australian Governments (COAG), Prime Minister Turnbull floated a proposal to reintroduce state income taxes as a way of eliminating the "vertical fiscal imbalance." However, all but one of the state and territory leaders quickly rejected the proposal.

Croatia

Score 4

After six consecutive years of recession (2009–2014) the Croatian economy returned to growth in 2015. In 2017, real GDP kept growing, at a rate of approximately 3%. In the period under review, economic policy was largely preoccupied with the economic problems of Agrokor, a large food-and-retail chain whose 143 companies and almost 60,000 employees have made it the biggest private holding in Croatia and the western Balkans. In April 2017, parliament adopted the Law on the Procedure of Extraordinary Administration in Companies of Systemic Importance for the Republic of Croatia (the so-called "Lex Agrokor") which handed over control from Ivica Todorić, Agrokor's politically well-connected founder and main owner, to an "extraordinary trustee" in charge of drafting a settlement plan. Interpretations of this move have differed strongly. While the government has argued that it was necessary to prevent an uncontrolled collapse of Agrokor that could have triggered a chain reaction and put the Croatian economy back into recession, critics interpreted it as an attempt to deflect criticism from Minister of Finance Zdravko Marić, who had worked for Agrokor before joining government, and to take advantage of the situation in order to redistribute assets to connected individuals. In May 2017, the controversies over Agrokor led to the break-up of the governing coalition. While Prime Minister Plenković managed to find a new coalition partner for his HDZ, the new coalition has largely refrained from addressing the structural problems and the weak competitiveness of the Croatian economy. Save for the tax reform in late 2016, no major structural reforms were adopted in the period of review.

Citation:
European Commission (2018): Country report Croatia 2018 Including an In-Depth Review of the prevention and correction of macroeconomic imbalances. SWD(2018) 209 final, Brussels, 21 (https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-croatia-en.pdf).

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Cyprus

Score 4

Since Cyprus exited its bailout program in March 2016 post-program surveillance reports praise the successful implementation of policies which accelerated growth and improved performance on some economic indicators. Despite these improvements, levels of confidence in the economy and on competitiveness remain low.

Seeking support by the European Stability Mechanism (ESM), in 2012, became necessary after the failure of an economic model that had ensured sustained growth for three decades. That model was founded on a market-oriented economic system and macroeconomic policies. Its main assets were a skilled labor force and a system of trilateral bargaining that secured productivity and labor-market stability. Today, Cyprus is in search of a new model to enhance its competitiveness and renew its role as an attractive center for investment. Its main assets remain infrastructure, technological readiness, health and education. These assets are coupled with high quality legal and accounting support services and favorable taxation. The island's geographic location and EU membership further these advantages.

In implementing the terms agreed to with Cyprus's creditors, the government's reform program and new policies were hindered by severe credit constraints. Efforts to reestablish confidence in and stabilize the financial system have thus far yielded a downsized financial sector controlled by stricter rules and enforcement mechanisms, ensuring the viability of the struggling banking sector.

Compliance with the terms of the MoU with creditors has been aided by tourism growth, large construction projects and private consumption. The IMF has forecast economic growth at 3.6% in 2017 and 3.75% in 2018. However, risks and major challenges that are barriers to economic sustainability remain unresolved. These require, among other things, shifting economic activity from seasonal to perennial sources, reforming the public sector, accelerating the settling of non-performing loans and privatizing state-owned enterprises. The EU notes challenges from trade imbalances and, in concord with the IMF, note the risks of relying on foreign funding for large construction projects.

In 2017, progress on adopting policy solutions continued to be stymied by conflicts between the government and parliament. Moreover, political expediency is evident in recent government and parliament decisions reversing previous positions, a change possibly due to the January 2018 presidential elections.

Citation:
1. Post-programme EU Commission Surveillance Report, Spring 2017, Published July 2017 https://ec.europa.eu/info/sites/info/files/ip058_en_1.pdf
2. IMF Mission Statement, October 2017 http://www.imf.org/en/News/Articles/2017/10/06/ms100617-cyprus-staff-concluding-statement-of-the-2017-article-iv-mission
3. Global Competitiveness Index – Cyprus, World Economic Forum, 2017, http://reports.weforum.org/global-competitiveness-index-2017-2018/countryeconomy-profiles/#economy=CYP

Greece

Score 4

Greek economic policy is still bound by the Third Economic Adjustment Program (supported by a €86 billion bailout), based on a July 2015 agreement reached by

Greece and its creditors and approved by the Greek parliament in August 2015. It is also an economic policy still constrained by the capital controls imposed in July 2015. Capital controls, which are still imposed on Greek citizens and businesses, were put in place to avoid a bank run after the Syriza-ANEL government launched a referendum in July 2015 on one of the drafts of the economic reform proposals, which at the time the government was still negotiating with the European Commission.

The country has started to recover since the shocks of 2015. One of the Third Program's major goals is to save the Greek banking system, which still faces risks because of un-serviced loans to households and businesses.

The second review of economic policy measures, included in the Third Program, should have been completed in early 2016, but was finally accomplished with considerable delay in the summer of 2017. In the fall of 2017, the third review of Greece's program started. The review was delayed as Greece's creditors and the Greek government could not agree on major labor market reforms.

In July 2017, Greece returned to the sovereign debt market for the first time in three years, using incentives to win over hesitant investors to a €3 billion bond sale. However, access to the public capital markets continues to be the largest hurdle facing Athens as it attempts to exit the era of bailouts.

Meanwhile, there has been no progress in managing the growing un-serviced bank loans nor has there been any visible progress with regard to out-of-court conflict resolution processes which, if established, would have helped to spur stalled private investment plans.

During the period under review, the Syriza-ANEL government substantially raised indirect and direct taxes, including private income and property taxes. Such high (and in fact sudden) changes in taxes have contributed to economic stagnation. While raising taxes has already increased government revenue, the key to economic development lies in private investment which is not forthcoming. This is shown in the fact that in 2016 Greece's real GDP growth rate was zero (0.0%), while the average for the period 2006 – 2016 was -2.7%.

Prospects for economic growth are somewhat better than in 2016, although foreign investors still encounter significant bureaucratic obstacles, if not outright reluctance by government officials, when trying to implement their investment plans. In the period under review, as in 2015 – 2016, this situation was reflected in the long delays involved in the progress of major investments such as gold mining (e.g., Eldorado Gold company in Halkidiki) and urban development (e.g., the consortium of companies that bought land that had belonged to Athens Airport in Hellenicon, Attica).

Given that the Greek public debt remains at forbiddingly high levels (180% of the

GDP in 2017), the European Union, the European Central Bank and the IMF may soon need to devise a plan for a large-scale debt restructuring that will entail substantial losses for creditors. The German federal parliament elections in autumn 2017 did not bring about a shift in the stance of Greece's major lender: Germany remains reluctant to grant Greece major debt relief.

Citation:
Data on GDP growth are available from Eurostat: http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Real_GDP_growth,_2006-2016_(%25_change_compared_with_the_previous_year;_%25_per_annum)_YB17.png

Hungary

Score 4

The Hungarian economy returned to growth in 2013. Growth of real GDP slowed from 3.1% in 2015 to 1.9% in 2016 but reached almost 4% in 2017. Benefiting from the resumption of EU-funded investment, a fiscal stimulus, negative real interest rates and a strong increases in wages, economic growth was primarily driven by gross fixed capital formation and household consumption. Concerns about the sustainability of economic growth have been raised by the low potential growth rate, which is estimated at below 3% and has suffered from weak productivity growth. A general problem of economic policy is the high influence of so-called Fidesz oligarchs. Mega-projects such as the construction of the site for the 2017 World Championship in Watersports on the Pest side of the Danube, or the Paks-2 nuclear station, which have contributed to the rise in investment, have largely meant to provide business opportunities for this network. In order to improve the competitiveness of the Hungarian economy, the government established a National Competitiveness Council under the leadership of Minister of national economy Mihály Varga in March 2017. However, its initial measures have been largely confined to changes to registering firms and simplifications in construction permits and have thus failed to tackle the more fundamental problems of the Hungarian economy such as the lack of R&I, weak education outcomes, a growing shortage of skilled labor and a low transparency and reliability of policymaking. Echoing the government's new emphasis on improving competitiveness, the Hungarian National Bank has begun to publish annual Competitiveness Reports.

Citation:
European Commission (2018): Country Report Hungary 2018. SWD(2018) 215 final, Brussels (https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-repor t-hungary-en.pdf).
Hungarian National Bank (2017): Versenyképességi Jelentés 2017 (Competitiveness Report 2017). Budapest (http://www.mnb.hu/letoltes/versenyke-pesse-gi-jelente-s-hun-digita-lis.pdf).

Japan

Score 4

Recent macroeconomic developments have been mixed. The seven quarters through the end of September 2017 have been a period of continuous growth, the longest such stretch of unbroken expansion since 2001. While this is a notable achievement, annualized growth rates have remained relatively modest, and structural constraints in terms of demography and labor-market rigidities continue to cast a shadow on future growth prospects. The real growth rate in fiscal year 2016 – 2017 was 1.2%. The goals of a 2% annual inflation rate and concomitant increases in inflation expectations have not been achieved. In mid-2017, the Bank of Japan postponed the forecasted achievement of its 2% inflation objective for a sixth time, with the target date now fiscal year 2019 – 2020. The achievement of higher consumption and inflation rates has also been made difficult in the face of resistance by large enterprises tto raise wages significantly (in spite of government pressure to do so).

In August 2016, the government announced a new multiyear JPY 28.1 trillion (€245 billion) stimulus program. In parallel with the October 2017 snap election, Prime Minister Abe announced yet another JPY 2 trillion (€15 billion) stimulus package for the end of the year, raising further fiscal-consolidation concerns.

Despite this consistent government and central-bank activity, and despite the presence of significant company cash holdings from retained profits, consumption and domestic investment levels remain weak, as optimism about the economic future has remained at a low ebb.

In terms of trade policy, the Japanese government was able to achieve significant progress in 2017 by leading efforts to conclude a revised trans-Pacific free-trade agreement (dubbed the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, CPTPP) without the United States, and including exemptions in some controversial areas, as well as by finally reaching agreement with the European Union to conclude a bilateral FTA, which had been in the making for four years and might take effect in 2019.

Citation:
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Romania

Score 4

In 2017, Romania was the EU country with the highest economic growth. With more than 6%, real GDP grew much stronger than originally expected. Private consumption was the main driver of growth, supported by cuts in VAT and strong increases in wages and pensions. With its highly procyclical fiscal policy, the Grindeanu and Tudose governments have contributed to the overheating of the Romanian economy which is growing above potential. At the same time, they have done little to improve the medium- and long-term prospects of the Romanian economy, thus raising concerns about the sustainability of economic growth. While private investment recovered, public investment fell by more than 2 percentage points in 2017. Both governments have failed to address long-standing problems of the Romanian economy such as a weak education system, bad infrastructure, cumbersome procedures for businesses and frequent regulatory changes.

Citation:
European Commission (2018): Country report Romania 2018. SWD(2018) 221 final, Brussels (https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-romania-en.pdf).

Turkey

Score 4

The July 2016 failed coup increased political and economic uncertainty within the country. Since July 2016, a state of emergency has been imposed. A very substantial number of public employees have been suspended or dismissed, while many people have been detained and many companies have been taken over by the state. The government alleges that these extreme measures are necessary, because these people and companies have links to terrorist organizations. Consequently, households delayed spending especially on durable goods and corporations postponed key investment decisions, resulting in lower consumption and investment. State takeovers of private companies has had particularly adverse effects on private investment and foreign direct investment. Furthermore, a series of terrorist attacks have weakened tourism and foreign investment. Finally, domestic economic actors expect a tightening of global liquidity to constrain foreign borrowing and in the medium term increase Turkey’s external requirements. In turn, this will pose downside risks to economic growth and employment.

Turkish GDP expanded by 3.2% in 2016. According to the IMF, the GDP growth rate during 2017 will be around 5.1% due to fiscal stimulus and credit expansion. GDP declined from $934.1 billion in 2014 to $859 billion in 2015, and increased slightly to $863.4 billion in 2016. On the other hand, Turkey’s inflation rate, based on the consumer price index, increased slightly from 7.7% in 2015 to 7.8% in 2016. The country’s annual inflation rate in September 2017 was 11.2%. Thus, the 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 an employee increased by 13.3% in 2015 and 20.1% in 2016. According to the most recent figures, hourly labor costs increased by 13.7% on a year-on-year basis during the second quarter of 2017.

The banking sector has proved resilient to global financial crisis due to robust capital buffers and a healthy loan portfolio. After the failed coup attempt in July 2016, the government's overarching goal has been to avoid a substantial economic slowdown. As a result, the government decided to relax prudential norms in the banking sector, reduce provisioning requirements for restructured loans in the tourism and energy sectors, and lower regulatory risk weights on consumer loans and credit cards. As a result, credit growth has been substantial and the annual credit growth rate was 23.5% in June 2017. But these measures have been criticized by the IMF's latest Financial Sector Assessment Program (FSAP) report, which advises the Turkish government to strengthen banking sector supervision and governance, and enhance the regulatory framework for financial services.

In the field of monetary policy, after the failed coup attempt the central bank lowered reserve requirements, allowed greater use of gold and foreign currency, and offered unlimited lira liquidity against foreign exchange collateral. Between March and September 2016, the central bank gradually lowered the overnight lending rate by 250 basis points to 8.25%, leading to a substantial decline in the interbank overnight lending rate. Yet, at the end of November 2016, the central bank had to raise the one-week repo and overnight lending rates after a steep depreciation in the lira. Simultaneously, the central bank reversed the process of simplifying the monetary framework, which was based on the use of policy rate as the main monetary policy transmission tool. The central bank returned to its unconventional monetary policy, emphasizing the use of Late Liquidity Window rather than the use of policy rate.

Turkey's most significant economic problems continue to be related to external imbalances. While the current account deficit decreased from $43.6 billion (4.7% of GDP) in 2014 to $32.1 billion (3.7% of GDP) in 2015, and increased slightly to $32.6 billion (3.8% of GDP) in 2016, the current account deficit is still considerable. According to the IMF, the current account deficit is expected to increase to $39 billion (4.6% of GDP) in 2017.

Turkey's net international-investment position (NIIP) is 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. Turkey's NIIP deficit increased from $395 billion at the end of 2013 to $443 billion in 2014, but declined to $383.6 billion in 2015 and to $363 billion at the end of 2016. The country's net foreign debt at the end of August 2017 amounted to $462.4 billion. Considering Turkey's net foreign debt and the IMF's GDP estimate for 2017, the net-foreign-debt-to-GDP ratio for 2017 is approximately 55%.

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 4.17% of GDP and real GDP were to increase at its projected average annual growth rate of 3.54%, as predicted by the IMF for the period 2018 – 2022, then the country's net-foreign debt-to-GDP ratio would increase over the long term to an unsustainable 122.1%. Turkey must therefore reduce its current account deficit. A sustainable current account deficit-to-GDP ratio is likely around 2% of GDP. Since one of the main determinants of the current-account-deficit-to-GDP ratio is the real exchange rate, achieving a sustainable current account deficit will require a depreciation in the real exchange rate.

Citation:
World Bank (2017) World Bank in Turkey – Country Snapshot: The World Bank (October).

Address | Contact

Bertelsmann Stiftung
Carl-Bertelsmann-Straße 256
33311 Gütersloh
Germany
Phone +49 5241 81-0

Dr. Daniel Schraad-Tischler
Phone +49 5241 81-81240
daniel.schraad-tischler@bertelsmann-stiftung.de

Dr. Christof Schiller
Phone +49 5241 81-81470
christof.schiller@bertelsmann-stiftung.de

Dr. Thorsten Hellmann
Phone +49 5241 81-81236
thorsten.hellmann@bertelsmann-stiftung.de

Pia Paulini
Phone +49 5241 81-81468
pia.paulini@bertelsmann-stiftung.de

www.bertelsmann-stiftung.de
www.sgi-network.org

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