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Europe's National-Level Structural Reform Priorities

Nina Budina, Oyun Adilbish, Diego Cerdeiro, Romain Duval, Balázs Égert, Dmitriy Kovtun, Anh Thi Ngoc Nguyen, Augustus Panton, and Catalina Michelle Tejada

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ABSTRACT: Europe has a large and persistent per capita income gap with the United States. Deficiencies in total factor productivity, labor utilization, and capital intensity all play a role. While deeper intra-Europe integration is one key element towards closing these gaps, remaining structural domestic policy gaps with respect to most growth-friendly regulatory settings highlight the scope for complementary policy action at the national level. This paper compiles IMF staff's structural policy priorities for European countries to lift output over the medium term, reviews key implementation challenges, and discusses complementarities with EU-level efforts. While addressing these domestic reform priorities will require overcoming long-standing political economy and—in some cases—technical obstacles to reform, successful implementation could entail sizeable medium-term gains of around 5, 7 and 9 percent for advanced European, Central Eastern and Southeastern European, and Western Balkan economies, respectively.

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WORKING PAPERS

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Executive Summary

Europe has a large and persistent per capita income gap with the United States, and intra-European differences in living standards are also sizeable. Deficiencies in total factor productivity, labor utilization, and capital intensity all play a role. While deeper intra-Europe integration is one key element toward addressing these weaknesses, remaining structural domestic policy gaps with respect to most growth-friendly regulatory settings highlight the scope for complementary action at the national level. This paper compiles and assesses domestic structural reform priorities for individual European countries to lift output over the medium term.

Building human capital and improving the functioning of labor markets stand out as critical priorities across Europe. Reforms in these areas could not only further raise employment rates of youth, women, and older workers where these remain low, but also boost productivity by improving workers' ability to move across jobs and seize upon new technological opportunities.

With many European economies facing short-term fiscal consolidation needs, longer-term spending pressures, and persistent tax and spending inefficiencies, growth-friendly fiscal-structural reforms are also a high-priority area across Europe. These include tax policy and pension reforms in advanced Europe, as well as improvements in fiscal and public investment management frameworks, and SOE reforms, in some CESEE economies.[1]

For most advanced European economies, which are typically closer to the technological frontier, boosting innovation is central to the growth agenda. Priorities include further product market deregulation, deepening domestic credit and capital markets, and enhancing innovation and digitalization policies. For some CESEE countries, strengthening the rule of law is critical to reap the gains from other reforms and sustain productivity and income-per-capita convergence. For many CESEE and Western Balkan countries, improving governance remains critical.

Addressing these priorities will require overcoming long-standing political economy obstacles to reform and, in some cases, also technical implementation challenges.

The potential gains are large. Focusing just on the subset of reforms for which some quantification is possible, illustrative estimates suggest that implementing the priorities identified by IMF staff could raise GDP by around 9 percent in the Western Balkans, 7 percent in the CESEE region, and 5 percent in advanced economies excluding CESEE over the medium term.

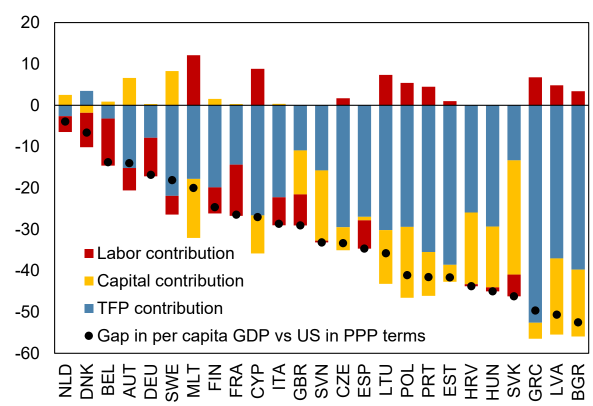
Pursuing these domestic efforts in tandem with an EU-level reform push would magnify their growth impact, due to important complementarities. In particular, EU-level action to complete the capital markets union would greatly improve the effectiveness of domestic efforts to deepen venture capital markets, while streamlining domestic business regulations would enhance the effectiveness of EU-level efforts to complete the single market for goods and services.

[11] Economies from Central, Eastern and Southeastern Europe, Including Western Balkans (See notes to Table 1).

I. Europe's economic performance and its structural policy gaps

Europe has a large and persistent per capita income gap with the United States, while intra-European differences in living standards also remain sizeable. As of 2024, the per capita income gap with the United States was close to 30 percent for many advanced European economies and even larger for others (Figure 1). While a few European countries are near U.S. per capita income levels (e.g., Denmark, The Netherlands), most lag far behind. Deficiencies in labor utilization, capital intensity, and—most importantly—total factor productivity all play a role. Going forward, these longstanding deficiencies will compound with a demographic outlook that can mechanically lower the aggregate participation rate and may also weaken innovation (for example, see Note 1 in IMF, 2024c).

Figure 1. Decomposition of GDP per capita difference with the US
(in PPP terms, 2024)



Source: AMECO; WEO; and IMF and staff calculations.
Note: CESEE includes Bulgaria, the Czech Republic, Croatia, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovenia, and Slovak Republic. Data are estimates as of November 2024.

These gaps can be partly traced back domestic structural policy weaknesses that impede economic convergence in lagging countries.[2] While deeper intra-Europe integration is one key element towards lifting Europe's growth potential (see Arnold et al., 2025, forthcoming), an extensive body of research traces income-per-capita gaps back to structural policy gaps in areas such as capital, product and labor market regulations, human capital formation or governance.[3] Comparing each European country's position vis-à-vis the "frontier"—defined as the most growth-friendly policy setting within the group of European countries and the United States, abstracting from other key (social, environmental) objectives of structural policies—for a large range of macrostructural areas can point to the largest structural policy gaps in the region.[4] With this in mind, a comprehensive database of structural policy indicators is assembled and classified into the following broad areas: labor market and human capital; business regulation; innovation policies; credit and capital markets; external sector; and

[2] See also IMF (2016, 2019), Budina et al., 2023, Eggert and Gal (2017) and García et al. (2024), for the use of similar indicator-based approaches.

[3] See, for example, the papers cited in Alesina et al. (2024).

[4] Throughout the paper, the frontier is defined as the average of the top-2 countries with the most growth-friendly policy settings on each structural policy indicator among 44 European economies and the United States.

governance.[5] After rescaling each indicator to a 0-100 range (with 100 being the frontier, defined as the average of the two countries with the most growth-friendly settings), the distance to frontier is calculated and then aggregated up for each broad structural policy area defined above (Table 1; see Annex I for further details).

Table 1. Macrostructural Reforms Heatmap by Country Groups

Structural area	EUR	CESEE	AE ex.CESEE	USA
Governance	73	61	85	80
External sector	87	84	90	85
Business regulation	67	63	70	89
Innovation	65	58	70	84
Labor and human capital	78	75	80	86
Credit and capital markets	58	47	67	101
Fiscal structural	74	67	81	88

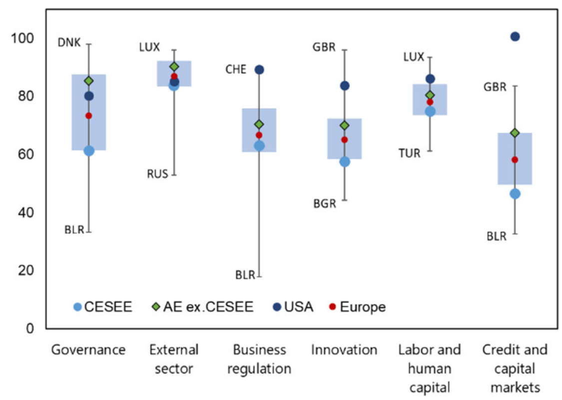
25 50 75

Notes: The table shows the distance to the frontier (most growth-friendly settings) for a range of indicators in each structural policy area in the latest available year (see Annex I). The frontier is defined as the average of top-2 countries on each structural policy indicator among 43 European economies and the United States. Indicators are normalized to 0-100, with 100 representing the frontier. A value above 100 for the United States indicates that the other frontier country lags behind U.S., so that the average frontier score is equal to 100. The Heatmap is mostly based on 2022, with some exceptions depending on the variable and the source; therefore it does not capture most recent developments in the various policy areas, such as trade policy. Some surveys are only available in certain years. EUR includes 43 European countries. AE excluding CESEE comprises AUT, BEL, CHE, CYP, DEU, DNK, ESP, FIN, FRA, GRB, GRC, IRL, ESL, ISL, ISR, ITA, LUX, MLT, NLD, NOR, PRT, and SWE. CESEE comprises ALB, BGR, BIH, BLR, CZE, EST, HRV, HUN, LTU, LVA, MKD, MDA, MLD, MNE, POL, ROU, RUS, SRB, SVK, SVN, TUR, and UKR.
Sources: IMF, OECD, World Bank, Fraser Institute, Eurostat, European Commission, World Economic Forum, WTO, Global Trade Alert, and IHS Markit.

[5] We construct a comprehensive database of structural indicators using the latest available data from IMF, OECD, World Bank, Fraser Institute, Eurostat, European Commission, World Economic Forum, WTO, Global Trade Alert, and IHS Markit. Policy *gaps* for each country are computed by comparing country performance to the respective frontier on each indicator. The value of each indicator is normalized to a 0-100 scale where 100 denotes the frontier. Caveats include the absence of indicators for some structural policy areas and specific European countries, the focus of some of these indicators on a mix of outcomes and actual policies—rather than strictly the latter (e.g. on education or innovation) and incomplete information (e.g. *de jure* rather than *de facto* stances) captured by available indicators. All the indicators used in the paper are consistent with the IMF's Third-Party Indicators (TPI) Guidelines. The Worldwide Governance Index is a perception-based indicator. See Annex I for further information.

While Europe has leading examples in many areas, overall available indicators show significant structural policy gaps relative to the frontier and, therefore, much remaining scope for growth-enhancing reforms. The region includes leaders in some structural areas, such as innovation, digitalization, and R&D incentives (United Kingdom, Finland, Denmark, and the Netherlands), governance (Denmark), and labor and human capital (Luxembourg, Switzerland). Nonetheless, there are still significant gaps, especially in areas such as labor market and human capital policies,[6] business regulations, innovation, and capital markets (Figure 2). CESEE countries face larger policy gaps in general, but particularly so in governance and credit and capital markets. Within the CESEE region, Western Balkans lag the most across all the main areas. Efforts to narrow these gaps over the last two decades have been uneven, with significant reform efforts in some areas—for example, in labor market and business regulations—and lack of progress in others (see Annex II).

Figure 2. Europe: Distance to Frontier in Selected Structural Policy Areas, 2022*
(Percent relative to frontier)



Sources: Fraser Institute; OECD; GTA; Eurostat, Berkeley; IMF, World Bank; and IMF staff calculations.
Note: Most indicators are from 2022. Frontier is defined as the average of top 2 countries from Europe and USA. Frontier = 100; all other values are normalized to this reference. The whiskers represent the range between the minimum and maximum values, while the bars indicate the interquartile range, spanning from the 25th to the 75th quartile. Regional numbers are simple average. ALB, MKD, MNE, and SRB are excluded from credit and capital markets; BLR and BIH are excluded from labor and human capital; MNE is excluded from external sector due to data availability. Countries with minimum and maximum values in Europe are labeled in each whisker' end.

While these indicators point to significant room for reform, identifying *specific reform priorities* for each country requires factoring in several additional considerations. First, the magnitude of the output effect from closing these structural policy gaps depends not only on their size—captured by the indicators—but also on the growth impact of closing them—which requires drawing on empirical or model-based estimates that are subject to uncertainty and require judgement. Second, the payoffs from reforms may vary across countries depending on

[6] Labor market and human capital policies include: (i) labor market functioning, linked to indicators of employment protection legislation (EPL), the labor tax wedge, and spending on active labor market policies; (ii) labor force participation, linked to indicators of total/female labor force participation rates; (iii) building human capital, including skill building, linked to indicators of skill mismatch measuring the overqualification rate (the share of employed with tertiary education in jobs that do not require such qualifications); and (iv) reforms to improve quality of education, linked to years of schooling and PISA score indicators (see also Annex I). In some areas, existing policy settings do not primarily seek to maximize employment or output, which is the specific perspective taken in this paper. In particular, labor regulations also pursue important job security, income protection and equity goals. However, there is growing recognition that such goals can be better met through well-designed unemployment benefit and social assistance systems than through stringent employment protection legislation, which is the indicator considered here (e.g. Blanchard et al., 2013, and Duval and Loungani, 2019).

their individual circumstances, reflecting interactions between different structural policies that are difficult to capture without careful consideration. For example, product market deregulation may incentivize more new firms to enter and compete with incumbents where the rule of law and broader governance is strong (IMF, 2019). Third, some important reform areas—for example, fiscal-structural, or the efficiency of the judicial system—may not be adequately measured by available indicators. Fourth, some of the indicators above do not readily imply actionable priorities as they capture a mix of outcomes and policies rather narrowly-defined policy settings (e.g. in education or innovation). For these reasons, a careful identification of domestic reform priorities should also tap country-specific knowledge, which is the goal of the next section.

II. Europe's domestic structural reform priorities

This section compiles key domestic reform priorities for each individual European country as identified by IMF staff. Specifically, this section draws on IMF country teams' judgement to identify top 5 country-level structural reform priorities for lifting medium-term output (Annex III, Table AIII.2).[7] These five priorities are derived from a combination of the structural policy gaps identified above, available estimates of the potential gains from closing them (discussed further below) and, importantly, IMF staff advice given in the context of Article IV consultations—which may cover areas not adequately covered by available indicators or quantitative estimates, and factor in other considerations relevant to a reform's growth impacts more broadly.

Labor market and human capital-building reforms

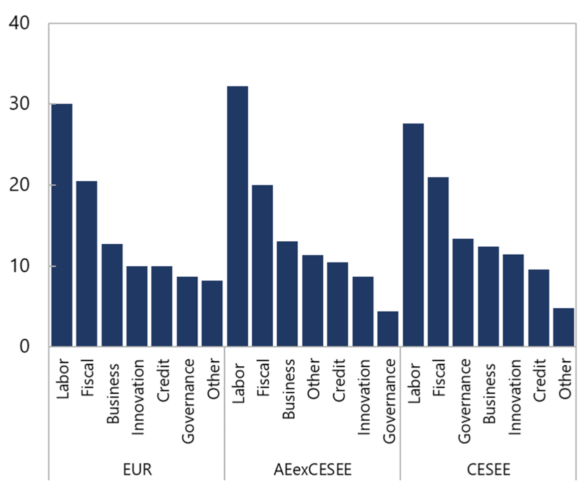
Across Europe, labor market and human capital-building reforms top the list of priorities in terms of both frequency and urgency. Almost all European countries have at least one top-5 reform priority in this area, which together account for some 30 percent of all identified priorities. Notwithstanding Europe's success in raising employment rates and increasing labor market flexibility in the last two decades, many European advanced economies (AEs) and CESEE countries would benefit from further action (Figure 3, left panel). A well-functioning labor market and a better trained workforce can not only raise output directly through higher labor input, but also lift productivity by reallocating workers more swiftly towards expanding industries and firms and helping them seize new technological opportunities (IMF, 2024a).

[7] The single focus of the paper on lifting medium-term output implies that the prioritization exercise omits other important objectives pursued by policymakers, notably income distribution and climate goals. While not considered for clarity and focus, climate-related reforms are central to the EU and other European countries' policy agenda. Meeting countries' green objectives will require further policy actions, including to boost carbon pricing and to foster green innovation. Green reforms that improve energy efficiency and support the transition to sustainable energy sources could also help address other medium-term structural challenges, such as energy security (Dolphin and others, 2024).

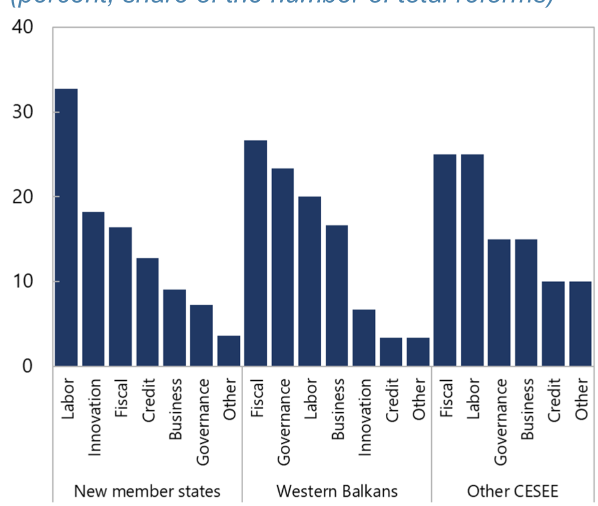
Reforms in this area are focused on mobilizing and efficiently allocating talent, with effects on both labor use and productivity. As illustrated by the word clouds in Figure 4, most frequently featured priorities across IMF staff recommendations include building human capital via improving education systems and scaling up training programs, incentivizing labor force participation by various population groups (females, young, and seniors), and attracting and integrating foreign workers, especially those with valuable skills. These reform priorities are followed, in decreasing order of importance in IMF staff's advice, by measures to enhance flexibility (e.g., easing strict employment protection legislation (EPL)) and reduce distortions that weigh on employment rates (e.g., lowering the tax wedge). Labor market reforms rank higher in AEs and CESEE new EU member states (NMS), with a focus on addressing labor shortages and headwinds from unfavorable demographic trends (e.g., Austria, Greece, Romania), skill mismatches (Denmark, Lithuania, Norway) and, to a lesser extent, easing EPL (Belgium, Spain). The relatively low incidence of EPL reforms is a testimony to improvements in this area in the past three decades, following reforms implemented by many countries.[8] In Western Balkan countries, labor market reforms rank comparatively lower compared to the rest of Europe primarily because other priority areas appear to be even more critical (Figure 3, right panel).

Figure 3. Assessed Top 5 Domestic Reform Priorities across Europe

Europe: Top 5 Reform Priorities by Area and Ranking
(percent, share of the number of total reforms)



CESEE: Top 5 Reform Priorities by Area and Ranking
(percent, share of the number of total reforms)



Note: The total number of reforms in a group of countries is the number of countries multiplied by 5. AEexCESEE comprises AND, AUT, BEL, CHE, CYP, DEU, DNK, ESP, FIN, FRA, GRB, GRC, IRL, ESL, ISR, ITA, LUX, MLT, NLD, NOR, PRT, SMR, and SWE. CESEE includes 11 new member states (BGR, BIH, CZE, EST, HRV, HUN, LTU, LVA, POL, ROU, SVK, and SVN), 6 Western Balkans countries (ALB, BIH, MKD, MNE, KOS, and SRB), and others (MDA, BLR, RUS, and TUR).
Sources: IMF staff's assessment.

[8] Examples include Germany ("Hartz reforms" in 2003–2005), Spain (2010-12), Portugal (2011-15), the Netherlands (2015), among others. See also Ciminelli, Duval and Furceri (2022), which documents major EPL reforms through the mid-2010s.

Figure 4. Reform Priorities Across Broad Structural Areas

Labor market and human capital reforms

Fiscal structural reforms

Business regulation reforms

Innovation reforms

Credit and capital market reforms

Governance reforms

Fiscal-structural reforms

Across Europe, fiscal-structural reforms come second in the ranking of priority areas, and even top the list of priorities in non-EU CESEE economies.[9] Fiscal structural reforms are among top-5 priorities in 16 AE and 15 CESEE economies, accounting for about 20 percent of all reform priorities across Europe. Implementing priorities in this area, such as tax and public investment management reforms, can reduce distortions and administrative burdens, leading to more efficient allocation of resources, higher productivity and in some cases improved labor utilization (Kouame et al., 2018). Enhancing fiscal sustainability by ensuring pension system sustainability (AEs) and improving the efficiency of public spending—particularly by enhancing SOE governance and public investment management (CESEE countries)—would free up fiscal space for productivity-enhancing public investments and expenditures on education and health. Sustainable pension systems that provide adequate social protection without encouraging excessively early retirement can also facilitate labor force participation of older workers and keep unemployment low through moderate social security contribution rates and overall labor tax wedges. Well-designed tax policies (AEs) are critical for mobilizing revenue while minimizing growth-reducing distortions, such as by relying on indirect taxes on consumption or property rather than direct, more distortive ones on labor and capital income.

Fiscal-structural priorities differ across country groupings. In AEs, identified priorities focus on improving the design of tax and pension systems, with a large share of social security and tax reforms ultimately aimed at enhancing labor market performance by reducing work disincentives (e.g., Belgium, France, Germany, Ireland, the Netherlands, Norway), or achieving a business-friendlier tax environment to lift productivity (Luxembourg, Portugal). Within the CESEE region, fiscal reforms top the list of reform priorities in Western Balkans and in other non-EU CESEE countries, with a focus on public investment management (e.g., Albania, Bosnia and Herzegovina, Moldova, North Macedonia) and SOE reforms (e.g., Belarus, Serbia). Within NMS CESEE countries, fiscal-structural reforms do not rank as high and comprise a mix of priorities found in AEs and CESEE (e.g., pension reforms in Czech Republic and Poland, public investment management in Bulgaria and Croatia, SOE reforms in Romania and Croatia).

Other reform areas

Productivity- boosting reforms, including streamlining business regulations, deepening domestic credit and capital markets, and enhancing innovation policy design also rank

[9] To the greatest extent possible, we focus on the effects of budget-neutral fiscal structural reforms on medium-term (potential) output, abstracting from any short-term effects from an increase in aggregate demand. In some cases, however, it is important to acknowledge that some of the reforms discussed under this category may not strictly be budget-neutral and may entail fiscal costs (e.g., education reforms), while second-order fiscal multiplier effects (due to differences in multipliers between the tax and spending items involved in the budget-neutral reform package considered) may still play out. Key priorities in this area include tax and pension system reforms, infrastructure and public investment management reforms, and SOE reforms.

high among growth-enhancing priorities. Business deregulation reforms are among top-5 priorities in 27 countries (13 percent of all reform priorities in Europe). They focus on cutting red tape (e.g., Cyprus, France, Germany, Hungary, Slovenia), reducing barriers to firm entry and exit (Austria, Belarus), and easing structural obstacles to construction (improving spatial planning in the Czech Republic, Slovenia and the United Kingdom, and streamlining land use procedures in Austria). Innovation, R&D, and digitalization-enhancing reforms are prioritized in about half of European economies (10 percent of all reform priorities), with a relatively lower ranking in Western Balkan and non-EU CESEE countries as would be expected from their greater distance to the technological frontier. Innovation reforms focus on policy support to R&D including better-targeted tax incentives and direct R&D public funding for innovation (e.g., Denmark, France, Czech Republic, Iceland, Luxemburg, Sweden), digitalization (Poland, the Netherlands, Hungary, Luxembourg, Latvia, Slovak Republic, and Slovenia), and strengthening AI use (France, Malta). Broadly speaking, in AEs the focus of innovation policies should be on enhancing the level and design of R&D support to push the technological frontier, while in CESEE it should be more on investing into digital infrastructure and skills and digitalizing public administrations to converge to the technological frontier (Annex III, Figure AIII 5). Credit and capital market reforms (10 percent of all reform priorities) are most often ranked higher in EU economies, mainly focusing on access to finance for innovative young firms (Estonia, France, Malta, Romania, Slovenia).

Many key priorities, including in the labor, human capital, financial and fiscal-structural areas, would support innovation through enhanced framework conditions. Innovation requires adequate skills, availability of risk capital financing for innovative firms, low barriers to entry and exit that put pressure on incumbent firms, labor regulations that facilitate swift labor (re)allocation and a growth-friendly tax system. Therefore, a broad range of reform priorities identified in this paper would support innovation, beyond those strictly falling under the innovation policies label (e.g., R&D incentives, digitalization).

For many in the CESEE region, reforms to improve governance are key, particularly for non-EU CESEE countries. More specific goals include control of corruption (Bulgaria, Hungary, Moldova) and strengthening the rule of law in the non-EU CESEE group (Albania, Bosnia and Herzegovina, Kosovo), while judiciary system reforms are also important in some AEs (Cyprus, Greece, Israel, Italy).[10]

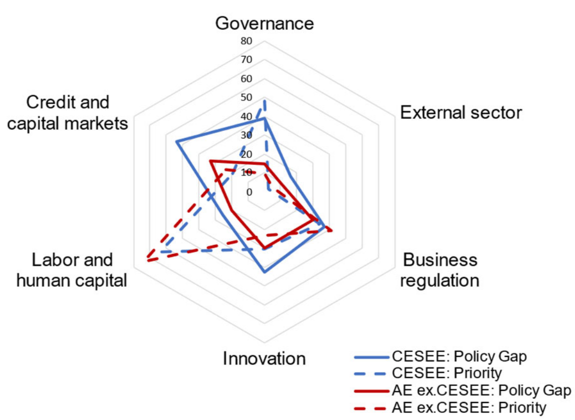
Overall, the reform priorities identified by IMF staff emphasize existing structural policy gaps, while taking into account the relative importance of domestic- vs EU-level initiatives in achieving progress. The identified top-5 reform priorities mostly align with CESEE countries' larger policy gaps in certain areas, not least governance (Figure 5, left panel).

[10] See Dai, Jarmuzek, and others (2025) for judicial reforms and their potential effects on investment and productivity in Greece.

The focus of advice on business regulation reforms also matches the sizeable policy gaps identified for all country income groups in this area. By contrast, despite large gaps vis-à-vis the frontier, domestic reforms in credit and capital markets do not feature prominently among reform priorities. However, as discussed further below, this is because of the critical role of EU-level reforms—primarily completing the CMU—in deepening countries' domestic capital markets. EU-level action is also critical—and indeed an EU-level competency—as regards the external sector, an area in which European countries are also closer to the frontier, explaining why domestic reforms in this area rarely feature among key priorities. Finally, the particularly strong emphasis on labor market and human capital reforms reflects a combination of large remaining gaps in CESEE countries, their criticality for productivity growth in advanced economies including through swifter labor reallocation, and their prospective role in supporting the demographic, digital, energy and green transitions.

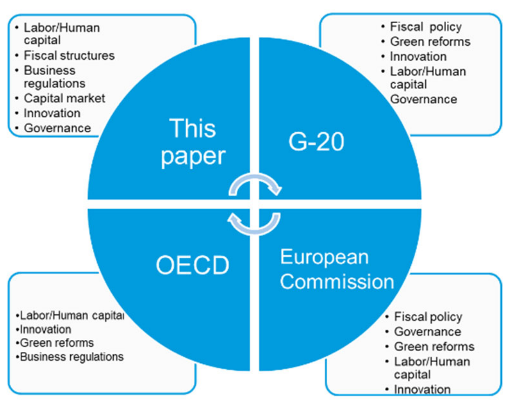
Figure 5. Alignment with Policy Gaps and Other Institutions' Priorities

Europe: Structural Policy Gaps v. Identified Priority Reform Areas



Note: Policy gaps and priorities are normalized to 0 to 100 scale. Higher policy gap indicates the sector is far from the frontier. Priority values represent the degree of priority of broad reform areas as assessed by IMF staff (See Annex III for more details).

Top Priority Reform Areas Identified by Other Institutions and Exercises



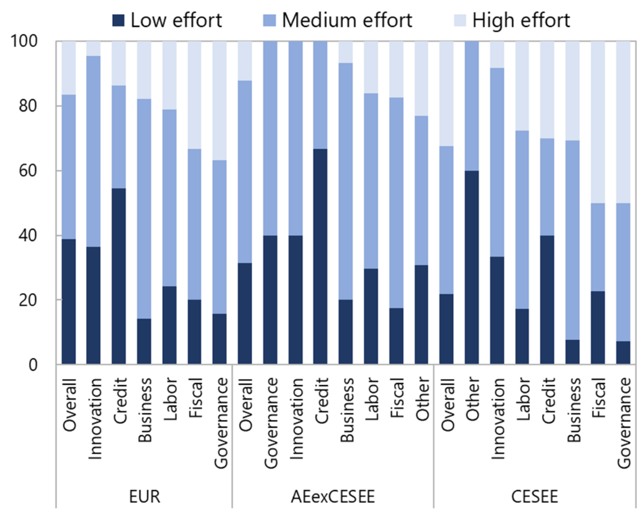
Sources: OECD, Going for Growth 2023; European Commission, Country Specific Recommendation; Strong, Sustainable, Balanced, and Inclusive Growth Report (SSBIG).
Note: This paper = This paper's analysis from the heatmap in Annex III; G-20 = The IMF produces annual G-20 Reports on Strong, Sustainable, Balanced, and Inclusive Growth to summarize progress toward SSBIG and recommended policy actions; OECD = Organization for Economic Co-operation and Development.

Domestic reform priorities are generally similar with those identified by earlier related exercises. The top-5 reform priorities overlap significantly with those identified by earlier analyses led by the European Commission or the OECD (Figure 5, right panel). Where differences arise, it is largely because of the broader scope of reform prioritization exercises carried out by these other institutions, which goes beyond increasing medium-term output to include also income distribution or climate objectives.

III. Factors impacting reform take-up and implementation

Successful implementation of priorities will require significant political efforts, even more so in CESEE countries. CESEE countries have more priorities than AEs in harder-to-reform areas, including governance. Compared to AEs, they also tend to benefit less from institutional setups that foster trust and dialogue among stakeholders from the early stages of policy design—features that have been found to raise awareness of the need for reform, correct misinformation and misperceptions about policies, and thereby build consensus in successful reforming countries (e.g., IMF, 2024b). For this reason, IMF staff also assess the political effort required for reforms to be higher in CESEE countries compared to AEs even *within* most areas (Figure 6).[11] In particular, over half of governance and fiscal reforms are assessed to require high political efforts in CESEE economies, compared to just about 15 percent in non-CESEE countries. In addition to strengthening communication and clearing misperceptions early on, governments across Europe could enhance the acceptability of politically-difficult reforms by combining them with other reforms that either help generate net gains more broadly across different stakeholders or build supportive constituencies. For example, the overall acceptability of a reform package combining job protection legislation reforms that regular workers may oppose with tax-spending reforms that cut labor taxation and thereby raise take-home pay could be higher than that of its individual parts. Another example

Figure 6. IMF Staff Assessment of the Political Effort Required for Identified Reform Priorities, by Region and Area
(share of total number of reforms in each area)



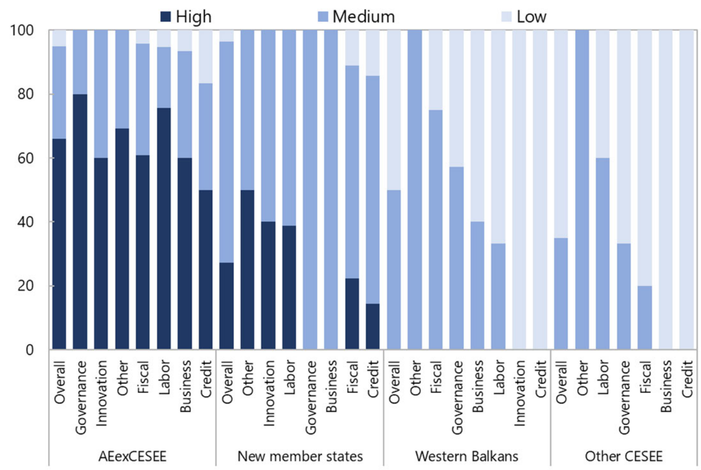
Note: AE ex.CESEE comprises AND, AUT, BEL, CHE, CYP, DEU, DNK, ESP, FIN, FRA, GRB, GRC, IRL, ESL, ISR, ITA, LUX, MLT, NLD, NOR, PRT, SMR, and SWE. CESEE comprises 11 new member states (BGR, BIH, CZE, EST, HRV, HUN, LTU, LVA, POL, ROU, SVK, and SVN), 6 Western Balkans countries (ALB, BIH, MKD, MNE, KOS, and SRB), and others (MDA, BLR, RUS, and TUR).
Source: IMF staff's assessment.

[11] For each European economy, IMF staff rated the "political feasibility" of reform (low, medium, or high), as well as the authorities' technical capacity to implement them (low, medium or high), which is discussed below.

would be combining governance reforms against which some incumbent firms may lobby with product market deregulation that potential new entrants may lobby for.

While obstacles to reform are predominantly political in nature, some priorities also require addressing technical capacity challenges. Looking across the different reform areas, deepening domestic capital markets generally requires high technical capacity, reflecting both the technical complexities involved and, for EU countries, the critical need for complementary action at the EU level—namely, the CMU agenda. Accordingly, IMF staff see reforms in this area as being technically more challenging compared to others, not only for CESEE countries but also for AEs (Figure 7). Looking across countries, some CESEE countries, especially non-EU countries, face more acute capacity challenges than AEs in general. This is the case in areas such as labor and product market regulations, where the scope for well-intended but poorly-designed reforms can be high. In these cases, reform implementation would benefit from capacity development efforts, including to address difficulties in prioritizing, designing, and monitoring deregulation measures, as well as from greater coordination among policy makers and stakeholders (including employer associations and trade unions).

Figure 7. IMF Staff Assessment of the Technical Capacity of Implementing Identified Reform Priorities, by Region and Area
(share of total number of reforms in each area)



Note: AE ex.CESEE comprises AND, AUT, BEL, CHE, CYP, DEU, DNK, ESP, FIN, FRA, GRB, GRC, IRL, ESL, ISR, ITA, LUX, MLT, NLD, NOR, PRT, SMR, and SWE. CESEE comprises 11 new member states (BGR, BIH, CZE, EST, HRV, HUN, LTU, LVA, POL, ROU, SVK, and SVN), 6 Western Balkans countries (ALB, BIH, MKD, MNE, KOS, and SRB), and others (MDA, BLR, RUS, and TUR).
Source: IMF staff's assessment.

IV. Interactions with EU-level reforms

The domestic and EU-level reform agendas interact in multiple ways. Conceptually, two reforms can be complementary, substitutable, or additive ("orthogonal") if the impact of implementing them jointly is superior, inferior, or equal, respectively, to the sum of the impacts from implementing each of them in isolation. Additivity prevails in areas that are either typically a domestic competency (e.g., governance, labor market regulation) or an EU-level one (e.g., external trade). In some other areas, such as product market deregulation, EU-level and domestic reforms may be mostly substitutes as either of them help foster competition and reduce markups.[12] For instance, the primacy of EU law and the binding nature of EU Directives can lead to reductions in entry barriers in domestic services that may be difficult to achieve domestically due to political obstacles to deregulation. In most areas, however, complementarity likely predominates, because failure to implement reform at one (domestic or EU) level can blunt the impact of—or even act as a binding constraint on—reform at the other level, as documented in this section.

Complementarities between domestic- and EU-level reforms deserve attention. One example is capital markets, which—given the size limitations of national economies—would be difficult to deepen through domestic reforms alone, highlighting their complementarity with, and the criticality of, completing the CMU at the EU level. Conversely, EU-level efforts to boost R&D can only be successful in spurring innovation if parallel progress is made at the domestic level towards enhancing human capital, whose scarcity could otherwise act as a constraint. Complementarity can also be at play in some areas of product market deregulation, when national governments add extra requirements when transposing EU directives (so-called "gold plating"), undermining single market integration and its pro-competition effect. The importance of these complementarities has also featured in recent EU policy debates (e.g., the Draghi and Letta reports). Accordingly, IMF staff identifies significant synergies between EU-level reforms—including capital market deepening, enhancing labor mobility, simplifying regulation across the single market, and enhancing digital and energy market infrastructure capacity and connectivity—and domestic reforms priorities (see Annex III).

Domestic efforts are essential for a successful deepening of the EU single market, because the effectiveness of EU-level initiatives might otherwise be constrained by existing policy settings in individual countries. For example, the effectiveness of measures to reduce barriers to cross-border labor mobility, such as the creation of pan-European pension products, might be significantly curtailed by within-country barriers to labor mobility (e.g., occupational pensions that do not allow within-country portability, or domestic barriers to entry—licenses, specific qualification requirements—in professional services). Likewise, efforts to strengthen cross-country infrastructure would be amplified by domestic reforms and public investment to improve local infrastructure in waste management, water networks, and road transport. Similarly, EU-level efforts to complete the single market for goods and services, including through directives, can be undermined through slow, incomplete and/or ineffective implementation motivated by national authorities' preference for keeping domestic regulations in place—as has sometimes been the case to protect domestic incumbent firms from deregulation

[12] In classical models of imperfect competition, the output loss from weak competition depends on the square of the markup, which implies that reducing the markup through one reform *reduces* the output gains from subsequent reforms.

in network industries such as electricity, telecommunications, rail transport or postal services, for example.[13] Similar motives can lead to the aforementioned "gold plating".
For this reason, domestic business (de)regulation reforms have the greatest potential to amplify the gains from the single EU goods and services market agenda. Specifically, easing entry barriers in product markets and reducing regulatory and administrative burdens would help in the harmonization of EU regulations and make it easier for firms to do business across borders. Examples cut across regions and per capita income levels (Austria, France, Greece, Hungary, Luxemburg, Montenegro, and Slovenia).

Conversely, domestic efforts could be amplified by reforms pursued at the EU level. Removing remaining intra-EU barriers to trade and factor mobility can boost the impact of domestic reforms that seek to enhance the allocation of factors of production at the national level (e.g., by addressing skill mismatches or improving the availability of capital for innovative startups). Similarly, the effectiveness of domestic measures to improve business dynamism by fostering entry and exit could be enhanced by lowering barriers to intra-EU trade, which would put domestic firms in stronger competition with firms from all across the EU—such as in finance or telecommunications, for example.

EU-level efforts may have the most amplification potential when it comes to domestic capital markets reforms. In particular, progress towards the CMU and improving EU-wide financial intermediation would complement domestic efforts to improve access to risky capital that promotes the availability of finance for innovative startups (e.g., Austria, Denmark, Finland, France, Germany, Spain, Netherlands, and Portugal). Countries with more advanced financial markets, which have less scope for further domestic action in this area and also happen to be closer to the technological frontier, would benefit the most from CMU progress, on average. Comparatively, in the CESEE region, a highly-liquid, bank dominated sector provides adequate investment financing while the need for innovation financing is mitigated by countries' greater distance from the technological frontier in most industries.

There are also strong complementarities when it comes to reforms promoting innovation and productivity-enhancing reallocation of resources. As regards innovation, enhancing EU-wide digital infrastructure—boosting connectivity, building data processing capacity, and ensuring resilience—can amplify the effects of digitalization efforts at the national level, especially in the CESEE region where the scope for progress remains generally greater (e.g., Hungary, Latvia, Slovak Republic, Slovenia).[14] Similarly, there are complementarities in the simplification of business regulations, with the reduction in remaining barriers to services trade at the EU level having the potential to amplify an easing of domestic entry regulations in those

[13] For example, Cresciolli (2024) finds that the effectiveness of European directives in reducing firm-level market power increased with the extent of preceding domestic pro-competition reforms.
[14] For further background on the EU's digital infrastructure, see European Commission (2024).

same services (e.g., in Finland), which could spur firm entry and innovation by both incumbents and entrants. EU-level action to foster intra-EU labor mobility, such as better recognition of professional qualifications and pension portability, is also complementary to innovation-focused domestic policies to enhance labor market flexibility—and thereby worker reallocation—and workers' human capital, as both of them would facilitate high-skill labor mobility within and across borders (Czech Republic, Spain, Estonia, Lithuania, Luxemburg, Norway, Serbia, and Slovak Republic). In a few cases, however, such complementarity needs to be weighed against the risk that stronger intra-EU mobility might foster "brain drain" (Malta, Moldova). Domestic labor market flexibility is also needed to maximize the benefits from cutting remaining intra-EU barriers to trade in goods and services, which would trigger a need to reallocate workers across firms and industries within member countries.

Completing the single EU energy market would also greatly amplify the effects of any measures taken by individual countries. Such EU-level effort is instrumental to deliver cheaper and less volatile energy and reduce cross-country differences in energy prices, including by alleviating redundant investments at the individual country level. This complementarity between EU and domestic policies may be most prominent in countries that suffered from large price spikes in the winter of 2022 (Cyprus, Greece, Moldova) and the summer of 2024, where an EU connectivity push would amplify the effects of scaling up the domestic grid and energy storage and help countries diversify their energy sources.

V. Gains from Implementing Reform Priorities

This section aims to illustrate the potential output gains from implementing the identified top 5 country-level structural reform priorities, based mostly on the quantification approaches in existing IMF and OECD studies. Specifically, we present estimates of the medium-term potential impact of those domestic priorities discussed in the previous sections that lend themselves to quantification, while also highlighting the limitations of such exercises, including sources of over- and under-estimation of reform impacts. We also include a qualitative discussion of potential gains from reform priorities that do not easily lend themselves to quantification or for which comprehensive impact studies may not be available.

Methodology and Caveats

We use a stylized quantification framework to provide of a range of medium-term (5-years ahead) output effects of prioritized reforms. For reforms whose impact on growth can be quantified based on existing studies, the exercise incorporates two key inputs that determine their potential dividends. First, the gains depend on the size of the structural policy gap assumed to be closed by implementing the reform priority considered. To anchor the analysis, we simulate an ambitious scenario in which countries close 50 percent of their prioritized policy gaps with respect to most growth-friendly regulatory settings ("the frontier"). Second, in each area, a country's reform gain depends on the medium-term output effect of closing 50 percent of the structural policy gap. To select the relevant output elasticities of individual reforms, we focus on a five-years-ahead horizon and draw on available IMF studies including, among others, on governance (Budina et al., 2023), business regulations, capital and credit market reforms (Duval and Furceri, 2018; IMF, 2019), labor market regulation (IMF, 2016), and fiscal structural reforms (IMF, 2014; Acosta-Ormaechea and Yoo, 2012). In a few cases, we use growth accounting to arrive at a potential output impact estimate—for example, to assess the potential output gain from closing female labor force participation rate gaps. For a number of reform areas, we also rely on OECD estimates either taken directly from, or using the same framework as in, Égert and Gal (2017) and Égert (2017). For innovation-related reforms, which are key to long-term growth, the GDP impacts are not quantified as the reform priorities are difficult to map with available indicators and their impact would likely materialize beyond this paper's medium-term horizon. Where relevant, such as in the fiscal structural area, we do our best to consider output elasticities of budget-neutral reforms (a one percentage point of GDP cut in personal income taxation offset by an VAT increase of similar size, for example). The overarching goal of this approach is to maximize the fraction of reform priorities whose effects can quantified. Reliance on both IMF and OECD estimates of reform gains, where available, also has the benefit of providing alternative estimates that can be cross-checked against each other.[15]

The estimates are subject to important caveats and should be seen as illustrative. There are potential sources of both under- and over-estimation of the reform impacts produced by this exercise, over and above the limitations of, and the uncertainty surrounding the effects obtained in the underlying empirical studies:

- *Sources of underestimation. First*, and critically, out of the 220 country-level reform priorities identified by IMF country teams discussed above, around one-third (and marginally more so for lower-income European economies) could not directly be mapped to any indicator. This is the case for many fiscal-structural reforms, for reforms in lower-income European economies that are not covered by available indicators, and for complex reforms—typically in advanced economies—for which no cross-country indicators exist (e.g., improving spatial planning). *Second*, the *de jure* structural policy gaps with respect to the frontier captured by existing indicators may under-estimate *de facto* gaps. *Third*, we do not account for economic interactions between reforms, which can materially influence their impacts (e.g., IMF, 2019; Budina et al., 2023), as well as single-market reforms that might enhance their effects (Arnold et al., 2025, forthcoming). *Fourth*, the approach does not account for general

[15] See Annex IV for further details on the methodology and baseline results.

equilibrium effects that could enhance the impact of at least some of the prioritized reforms (e.g., IMF, 2019).

- *Sources of overestimation. First,* reform gains are quantified assuming that countries close 50 percent of their structural policy gap with respect to the frontier. For countries farther away from the frontier, such a scenario is very ambitious by historical standards. *Second*, in some cases the reform priority identified by IMF country teams may actually be narrower in scope (e.g., passing an anti-corruption law) than the change in the structural policy indicator to which it is mapped to obtain a growth impact estimate—that is, a 50 percent reduction in the gap in the overall governance quality indicator vis-à-vis the frontier. *Third*, the use of average historical output elasticities fails to account for weak institutions and technical capacity that could dampen reform gains in some countries. *Fourth*, over-estimation could result from not accounting for the full general equilibrium effects of certain reforms. For example, reforms that increase labor force participation are assumed to leave labor productivity unchanged in the long term, which implicitly assumes that existing workers and new entrants into the labor force are equally productive.

Sizeable potential medium-term gains from domestic reform priorities

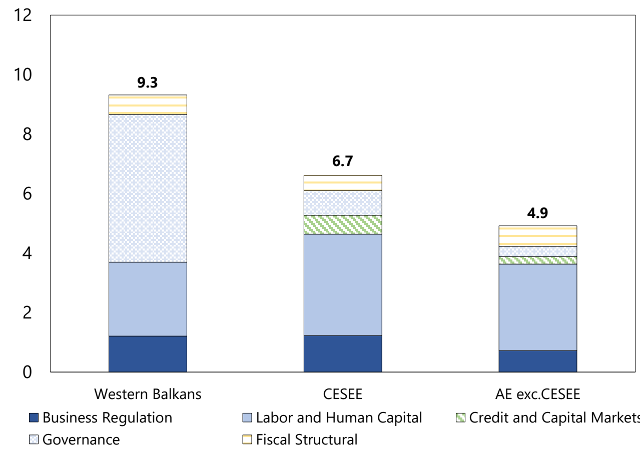
Potential reform gains are sizeable throughout Europe, but even more so for countries farther away from the frontier. Using the aforementioned approach suggests that implementing all prioritized reforms could lift the level of GDP in the medium term by over 9 percent to GDP in the Western Balkans, close to 7 percent in the CESEE region, and nearly 5 percent in advanced economies excluding CESEE (Figure 8). While there are sources of both under- and over-estimation around these estimates, risks of under-estimation are greater for lower-income economies, such as those in the Western Balkans, for which the share of prioritized reforms that could be quantified is lower.

The largest gains are estimated for labor market and human capital reforms, followed by business regulation, fiscal structural, governance, and credit and capital market reforms.

- *Labor market and human capital reforms* could add over 2.5 percent to GDP in the WB and Advanced EU economies, and over 3 percent in CESEE economies over the medium term. Country-specific reform priorities in this area include easing employment protection legislations to boost productivity (e.g., Belgium, Spain, Türkiye), reducing skill mismatches via active labor market policies (e.g., Czech Republic, Estonia, Lithuania) as well as raising labor supply by lowering the labor tax wedge (e.g., Denmark, Finland, Slovenia).

Figure 8: Europe: Medium-term GDP Gain from Closing 50 Percent of Prioritized Policy Gaps

(Percent)



Note: The estimated GDP impact of each reform in a region is the GDP-weighted regional average.
Western Balkans include Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia. CESEE excludes Russia and Ukraine. AE excludes CESEE and San Marino.
Sources: Fraser Institute, OECD, GTA, and IMF staff calculations.

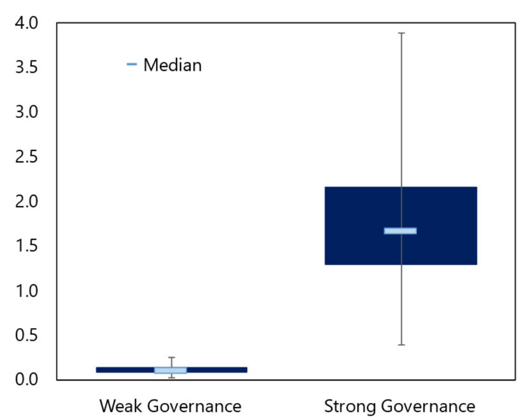
- *The prioritized business regulation reforms* could add over 1 percent to GDP over the medium term across WB and CESEE economies, and up to 0.7 percent in EU AEs. Examples include easing product market regulations to promote competition and innovation (e.g., Austria, Türkiye), harmonizing regional regulatory frameworks to improve market integration (e.g., Greece, Spain), and simplifying licensing and insolvency procedures to lower entry and exit costs (e.g., Hungary, Croatia).
- *Fiscal structural reforms* could add up to 0.7 percent to GDP in the WB and AEs, and up to 0.5 percent in the CESEE region. Gains would stem from strengthening pension system sustainability (e.g., France, Luxembourg, Poland), enhancing public infrastructure efficiency (e.g., Israel, North Macedonia), and improving SOE governance and management (e.g. Croatia, Serbia). The modest estimated output dividends in some countries reflect the assumed budget neutrality of reform implementation in our quantification exercise. More generally, even those reforms that may have a modest direct growth impact in the medium term can be critical for enhancing government efficiency, strengthening resilience to shocks, and enabling other reforms without increasing fiscal strain.
- *Credit and capital markets deepening* reforms could also deliver material dividends, adding up to 0.3 and 0.6 percent to GDP over the medium term in AEs and CESEE countries,

respectively. Priorities include enhancing the availability of risk-capital financing for innovation and startups (e.g., the Netherlands, Portugal, Poland, Slovenia), strengthening domestic capital markets to better channel savings into investment (e.g., Ireland), and advancing EU capital market and banking union reforms to enhance cross-border financing (e.g., Belgium).

- *Improving governance* would raise output directly through raising expected returns on investment, and also indirectly by amplifying the impact of other reforms, with higher dividends in the WB and CESEE regions where gaps vis-à-vis the frontier are larger. Direct medium-term output gains from the prioritized governance reforms in control of corruption (e.g., Moldova, Serbia) and judiciary reforms (e.g., Montenegro, Cyprus, Belarus) could range from 1 percent of GDP in CESEE to 5 percent in the Western Balkans. Judicial system reforms could also lead to sizeable gains in those AEs (e.g., Greece) where judicial system efficiency is low by EU standards (Dai, Jarmuzek, and others, 2025). These reforms strengthen institutions and thus enhance policy credibility, investor confidence, public sector efficiency and the effectiveness of other structural reforms such as product market deregulation, the gains from which have been found to be greater in countries where governance is strong (Figure 9) (IMF, 2019; Budina et al., 2023).

Careful sequencing of these reforms could not only maximize their gains but also facilitate their implementation. For example, while politically challenging, governance reforms that build capacity and create an enabling environment are generally popular with the broader public and amplify the gains from further reforms in other areas. Therefore, there is both an economic and a political economy case for prioritizing them. Likewise, exploiting the economic and political synergies between product and labor market reforms contributed to the success of major reform packages in AEs in the 1990s, such as in Australia, Ireland, or the Netherlands (Adhikari and others, 2018). Country-specific conditions should also guide reform execution (see Budina et al., 2023). In particular, available evidence indicates that the economic (e.g., expansion vs. recession) and political contexts (e.g.,

Figure 9. Medium-Term GDP Gain from Closing 50 Percent of Gap in Business Regulations, Conditional on Quality of Governance *(Percent)*



Note: Weak (strong) governance refers to a level of governance equal to the 25th (75th) percentile of the distribution of the governance quality index (see IMF October 2019 WEO Chapter 3). The sample includes ALB, BIH, CYP, HUN, ITA, KOS, MKD, MNE, and SRB.
Sources: Fraser Institute; OECD; IMF staff calculations.

pre-election vs. normal times) under which reforms are implemented shape their economic and political success (Duval and Furceri, 2018; Alesina and others, 2024).

Concluding Remarks

Unlocking Europe's full growth potential is a central challenge for European policymakers. Reducing the continent's overall large per capita income gap with the US, and with its own higher-income economies, calls for a new wave of decisive actions to remove structural obstacles to growth at both regional and national levels. This paper presents IMF staff's assessment regarding structural reform priorities at the national level to boost medium-term output, their political and technical feasibility, as well as their interactions with key EU-level reforms. The paper also gauges the potential magnitude of the output gains from implementing these reform priorities, drawing on the large existing literature on the impact of structural reforms.

Domestic reform priorities cut across multiple areas, with some variation across European countries depending on their current GDP per capita and structural policy gaps vis-à-vis the frontier. Human capital and labor market reforms are critical in many European economies: reducing skills mismatches, incentivizing labor market participation are key for raising productivity and softening the adverse impact from population ageing, respectively. Skill-building is critical for innovation, particularly in European AEs. Fiscal structural reforms also rank high in terms of frequency and urgency, aimed at reducing distortions in tax systems, addressing infrastructure gaps, and improving the sustainability of social protection systems in employment-friendly ways. Business (de)regulation reforms, more ambitious and better-designed policies that support innovation, and capital market deepening focused on improving availability of risk capital also rank high on the agenda, although their precise content may differ between AEs and CESEE economies depending on their proximity to the technological frontier. For countries outside the EU, which typically face larger policy and income per capita gaps, governance reforms are vital.

Successful implementation will require overcoming significant political and technical capacity challenges. Especially CESEE policymakers will need to put in strong political efforts, both because of the greater need for action in hard-to-reform areas such as governance, and because CESEE countries often lack consensus-building institutional setups—such as independent technical and advisory bodies, for example— that have helped reform acceptability in many AEs. Going forward, building such institutions, and engaging early and transparently with all stakeholders from the early stages of reform, could help foster trust, dialogue and, eventually, reform adoption. Across Europe, combining different reform efforts in a way that ensures net gains across various stakeholders could also help with implementation. In some cases, especially in non-EU CESEE economies, implementation challenges will also need to be overcome through capacity development efforts.

Potential output gains from implementing reform priorities could be sizeable. Bearing in mind wide uncertainty amid multiple sources of possible over- and under-estimation, analysis based on indicator-based policy gaps vis-à-vis the frontier and available estimates of the output effects of closing those gaps suggests that implementing the reform priorities identified by IMF staff could raise output in the medium term by around 5 percent in advanced economies excluding CESEE, 7 percent in CESEE economies, and 9 percent in the Western Balkans.

A coordinated push at national and EU levels could magnify the impact of reforms by exploiting multiple synergies. Complementarities between domestic and EU-level reforms predominate. For example, deepening capital markets through domestic reforms is needed but can only go so far, highlighting the criticality of EU-level progress towards completing the CMU. Conversely, efforts to cut remaining intra-EU barriers to trade in goods and services will have greater chances of success if national governments refrain from so-called "gold plating" and reduce their own domestic barriers to entry in services. Other complementarities are plentiful and should be exploited.

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Annex I. Calculating Policy Gaps

Policy gaps are calculated using readily available indicators. We construct a comprehensive database of structural indicators based on the available data from the IMF, OECD, World Bank, Fraser Institute, Eurostat, European Commission, World Economic Forum, WTO, Global Trade Alert, and IHS Markit. All indicators are consistent with the IMF's Third-Party Indicators (TPI) Guidelines. The Worldwide Governance Index used is perception-based.

The policy gaps are constructed by comparing each European country's stance vis-à-vis the "frontier". The frontier is defined as the average of the top-2 most growth-friendly policy settings within the group of European countries and the United States, abstracting from other key (social, environmental) objectives of structural policies. Then, policy gaps for each country are computed by comparing their performance on each indicator with the respective frontier, normalized to a 0-100 scale where 100 denotes the frontier. After rescaling each indicator, the distance to the frontier is calculated and aggregated for each broad structural policy area. Some of the caveats include the absence of indicators for some structural policy areas and specific countries, a focus of the indicators on a mix of outcomes and actual policies in certain areas (e.g., on education or innovation), and incomplete information (e.g., *de jure* rather than *de facto* stances) captured by available indicators.

The indicators were classified into seven broad areas, each of which typically consisting of several indicators:

- ***Governance.*** Using the Worldwide Governance Indicators (WGIs) this sector focuses on assessing the quality and effectiveness of governance systems.
- ***External sector.*** Indicators in this area assess economic freedom in trade and finance, focusing on the ability to freely exchange goods and services across borders. Tariff and non-tariff barriers represent restrictions to trade across borders, while data on FDI restrictions capture how open to foreign investors and businesses the economy is.
- ***Business regulation.*** Indicators of business regulation assess the risk of rising operational costs due to the domestic regulatory environment, including burdens related to reporting, permits, and licenses, as well as nepotism and discrimination in public administration. Barriers to entry in services and network sectors as well as data on firm entry and exit rates complement the analysis.
- ***Innovation and R&D.*** This area focuses on indicators to assess a country's capacity for technological advancement and its ability to foster a competitive and innovative economy; helping to assess how conducive the policy environment is for fostering innovation, driving technological advancements, and preparing for the future economy. Indicators included aim to

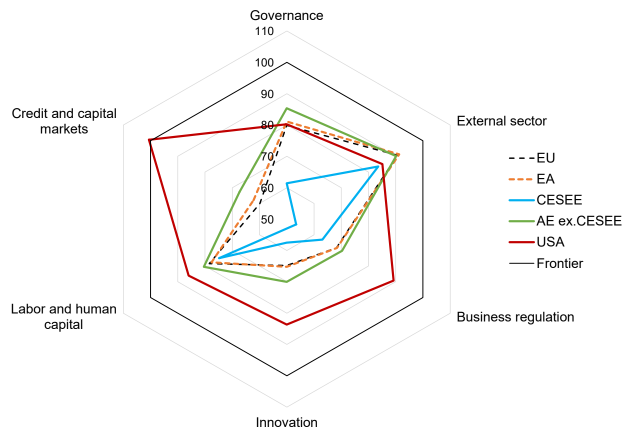
measure R&D tax incentives, digital economy and society index, innovation activities, investment in ICT, and AI preparedness for adoption.

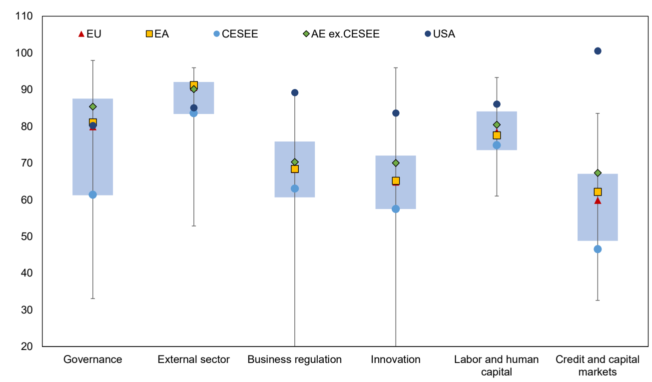
- ***Labor market and human capital.*** Indicators in this area assess the growth-friendliness of selected labor market regulations as well as the quantity and quality of human capital, providing insights into workforce quality and preparedness for industry needs and future work requirements.
- ***Credit and capital markets.*** This area focuses on indicators helpful to evaluate the robustness, accessibility, and overall health of financial systems. These indicators offer an assessment of the development and sophistication of financial markets, providing insights into the stability, accessibility, and efficiency of credit and capital markets, as well as comparative assessments of market development across different countries.
- ***Fiscal structural.*** The indicators included in this area provide insights into the growth-friendliness of fiscal policies, the effective retirement age as a key parameter of pension systems, and the overall quality of infrastructure that supports economic activities. To the greatest extent possible, we focus on the effects of budget-neutral fiscal structural reforms on medium-term (potential) output, abstracting from any short-term effects on aggregate demand such budget-neutral packages might still have.

Panel AI.1. Closeness to Most Growth-Friendly Settings in Macrostructural Areas by Region and Sector

Distance to Frontier in Selected Structural Policy Areas, 2022

(Percent relative to frontier)

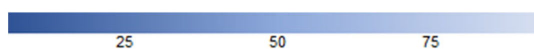




Structural Reform Gaps: Heatmap by Country Groups
(Percent relative to frontier)

Structural area	EUR	CESEE	AE ex.CESEE	USA
Governance	73	61	85	80
External sector	87	84	90	85
Business regulation	67	63	70	89
Innovation	65	58	70	84
Labor and human capital	78	75	80	86
Credit and capital markets	58	47	67	101
Fiscal structural	74	67	81	88

Alingment with Frontier	EUR	CESEE	AE ex.CESEE	USA
Governance	73	61	85	80
External sector	87	84	90	85
Business regulation	67	63	70	89
Innovation	65	58	70	84
Labor and human capital	78	75	80	86
Credit and capital markets	58	47	67	101
Fiscal structural	74	67	81	88



Notes: The panel shows the distance to the frontier (most growth-friendly settings) for a range of indicators in each structural policy area. The frontier is defined as the average of top-2 countries on each structural policy indicator among 43 European economies and the United States. Indicators are normalized to 0-100, with 100 representing the frontier. EUR includes 43 European countries. AE ex. CESEE comprises AUT, BEL, CHE, CYP, DEU, DNK, ESP, FIN, FRA, GRB, GRC, IRL, ESL, ISR, ITA, LUX, MLT, NLD, NOR, PRT, and SWE. CESEE comprises ALB, BGR, BIH, BLR, CZE, EST, HRV, HUN, LTU, LVA, MKD, MDA, MLD, MNE, POL, ROU, RUS, SRB, SVK, SVN, and TUR.
Sources: IMF, OECD, World Bank, Fraser Institute, Eurostat, European Commission, World Economic Forum, WTO, Global Trade Alert, and IHS Markit.

Table AI.1. Macrostructural Reforms Heatmap by Country Groups

25 50 75

	Structural area	EUR	EU	EA	CESEE	AE ex.CESEE	USA	Frontier 1	Frontier 2	Date	Source
I	**Governance**	73	80	81	61	85	80				
I_1	Political Stability	75	84	83	68	83	66	ISL	SMR	2022	WGI
I_2	Corruption	66	72	73	52	80	75	DNK	FIN	2022	WGI
I_3	Voice and Accountability	78	85	87	65	91	80	NOR	CHE	2022	WGI
I_4	Government Effectiveness	72	77	79	59	85	83	CHE	DNK	2022	WGI
I_5	Rule of Law	73	80	81	59	86	87	FIN	DNK	2022	WGI
I_6	Regulatory Quality	76	82	83	66	87	90	DNK	LUX	2022	WGI
II	**External sector**	87	91	91	84	90	85				
II_1	Measure of aggregate trade restrictions (MATR)	80	88	90	68	92	95	FIN	ISR	2022	MATR
II_2	Number of newly implemented trade or FDI measure (net harmful-liberalizing)	89	92	92	93	86	48	TUR	BLR	2023	Global Trade Alert
II_3	Mean tariff rate	96	96	96	95	97	100	ISL	USA	2022	WTO - World Tariff Profiles
II_4	Non-tariff trade barriers	82	88	90	75	89	81	LUX	MLT	2022	WEF - GCR
II_5	Services trade restrictiveness	80	85	85	78	81	88	ESP	CZE	2023	OECD
II_6	Barriers to trade facilitation	95	95	95	93	95	99	NLD	NOR	2023	OECD
III	**Business regulation**	67	68	68	63	70	89				
III_1	Regulatory Burden	64	62	63	57	72	90	FIN	CHE	2022	WEF - GCR
III_2	Bureacracy costs	77	82	83	71	82	77	ISR	EST	2022	IHS Markit.
III_3	Administrative burdens	83	86	85	87	81	79	POL	LTU	2023	OECD
III_4	Impartial Public Administration	75	82	84	64	87	82	DEU	SWE	2022	V-Dem Institute
III_6	Entry Rate	41	41	42	45	39	107	USA	MLT	2019	OECD DynEmp
III_5	Exit Rate	46	43	42	45	47	93	HUN	NOR	2019	OECD DynEmp
III_6	Distorton of the business environment	70	76	77	62	78	107	USA	DNK	2022	Fraser Institute
III_7	Barriers to entry in service & network sectors	76	74	72	75	77	78	CHE	SWE	2023	OECD
IV	**Innovation**	65	65	65	58	70	84				
IV_1	R&D tax incentives and direct government funding (% of GDP)	34	30	31	21	41	56	GBR	ISL	2022	OECD
IV_2	Digital Economy and Society Index	76	76	78	66	82		FIN	DNK	2022	Eurostat
IV_3	Innovation activities	72	72	72	67	76	94			2022	EIBIS
IV_3a	Percent of firms using advanced digital technologies	73	73	75	64	79	87	AUT	FIN	2023	EIBIS
IV_3b	Percent of firms introducing new products and processes	71	71	70	69	73	100	USA	NLD	2023	EIBIS
IV_4	Investment in ICT	62	62	59	58	63	87	SWE	CHE	2023	OECD
IV_5	AI preparedness for adoption	82	85	86	76	88	98			2023	IMF
IV_5a	Digital Infrastructure	82	86	87	75	88	93	DNK	EST	2023	IMF
IV_5b	Digital Innovation	80	84	85	70	89	97	ISR	SWE	2023	IMF
IV_5c	Human Capital	83	84	85	78	88	98	CHE	EST	2023	IMF
IV_5d	Regulation	84	87	88	79	89	102	USA	IRL	2023	IMF

Table AI.1. Macrostructural Reforms Heatmap by Country Groups (Cont.)

	Alingment with Frontier	EUR	EU	EA	CESEE	AE ex.CESEE	USA	Frontier 1	Frontier 2	Date	Source
V	**Labor and human capital**	78	78	78	75	80	86				
V	1 EPL	72	71	71	69	75	80				
V_1a	Strictness of employment protection	79	78	78	79	79	103	USA	CHE	2022	OECD
V_1b	Hiring and firing regulations	69	69	67	66	72	100	DNK	USA	2022	WEF - GCR
V_1c	Centralized collective bargaining	73	74	73	78	67	92	EST	LTU	2022	WEF - GCR
V_1d	Labor tax wedge	82	79	81	77	84	86	ISR	CHE	2022	OECD
V_1e	Active labor market policies expenditure (% of GDP)	55	53	52	38	66	14	CHE	AUT	2022	EC
V_2	Skill-mismatches: over-qualification	73	74	70	73	73		LUX	CZE	2022	Eurostat
V_3	Easing of hiring foreign labor	73	76	76	68	78	85	IRL	ALB	2022	Fraser Institute
V_4	Occupational entry regulation	76	74	72	71	77	83			2020	OECD OER
V_4a	Administrative burdens	84	81	80	84	84	97	CHE	FIN	2020	OECD OER
V_4b	Qualification requirements	60	56	54	44	64	58	FIN	CHE	2020	OECD OER
V_4c	Mobility restrictions	85	84	81	87	84	93	POL	SWE	2020	OECD OER
V_5	Labor force	81	80	80	78	83	83				
V_5a	Labor force participation, total, 15+	83	82	82	81	85	85	ISL	MDA	2023	World Bank
V_5b	Labor force participation, female, 15+	78	77	78	74	81	81	MDA	ISL	2023	World Bank
V_6	Building human capital	88	90	90	85	91	94				
V_6a	Human capital index	87	88	89	82	91	89	ISL	FIN	2024	UNDP
V_6b	Years of schooling	87	88	88	85	88	96	DEU	CHE	2023	UNDP
V_6c	PISA score	91	93	93	88	93	96	EST	IRL	2023	OECD
VI	**Credit and capital markets**	58	60	62	47	67	101				
VI_1	Central bank independence	78	81	81	71	83	88	SWE	CZE	2022	Berkeley
VI_2	Crisis preparedness of Insolvency Framewrok	76	81	84	61	79	102	USA	GBR	2022	IMF WP
VI_3	Percent of bank deposits held in privately owned banks	81	85	84	80	82	100	ALB	BIH	2022	World Bank; Cambridge University Press.
VI_4	Percent of firms that are financially	91	91	91	86	94	90	AUT	CZE	2022	EIBIS
VI_5	Interest rate controls/negative real interest rates	81	84	90	76	87	90	AUT	CYP	2022	Fraser Institute
VI_6	VC investments (% of GDP)	14	14	14	9	17	153	USA	EST	2022	OECD
VI_7	Financial Markets Index	42	46	50	14	69	99	CHE	USA	2023	IMF
VI_8	Financial Markets Depth Index	37	40	44	9	63	100	GBR	CHE	2023	IMF
VI_9	Stock market capitalization (% of GDP)	23	18	22	11	31	85	CHE	USA	2021	World Bank
VII	**Fiscal structural**	74	75	75	67	81	88				
VII_1	Average labour market exit age	74	72	72	68	77	88	ISL	ISR	2022	OECD; EC
VII_2	Logistics Performance Index - Quality of trade and transport infrastructure	83	87	88	75	91	92	FIN	DNK	2023	World Bank
VII_3	Public ownership	92	93	94	89	94	89	NOR	NLD	2023	OECD; PMR
VII_4	Direct taxes (% of GDP)	48	48	48	36	62	82	DNK	NOR	2024	IMF

Source: Fraser Institute; OECD; GTA; Berkeley; IMF; Eurostat; World Bank; and IMF staff calculations.

Note: Frontier is defined as the average of the top two country of Europe and USA. Frontier = 100; all other values are normalized to this reference. Given that the frontier is constructed as the average of the two top performers, when they have different values, the single top performing country will feature a normalized value above 100. In Fraser data sample, Europe excludes KOS, and SMR. In WGI data sample, Europe excludes BIH, KOS, MKD, MNE, SMR, and SVK. Regional numbers are simple average. The Heatmap is mostly based on 2022, with some exceptions depending on the variable and the source; therefore it does not capture most recent developments in the various policy areas, such as trade policy. Some surveys are only available in certain years.

Annex II: Evolution of Structural Policy Gaps

We explore the evolution of structural policy gaps over time based on the constructed database of available indicators with long time series. Specifically, we select indicators with roughly 20 (annual) observations to conduct the assessment. As in the main text, we compare each European country's stance vis-à-vis the "frontier", with the frontiers considered to be time invariant for simplicity, before aggregating normalized indicators for each broad structural policy area. Due to data availability limitations, the final set of indicators included in this exercise is smaller than the cross-section dataset used to compare countries. In detail:

- ***Governance.*** All six indices of Worldwide Governance Indicators (WGIs) as mentioned in Annex I are used.
- ***Business regulations.*** The regulatory burden and impartial public administration sub-components are considered.
- ***Labor market and human capital.*** Available indicators are grouped into labor market regulation (including hiring and firing regulation and centralized collective bargaining), and human capital buildup (including skill mismatches, years of schooling, and human capital index). We also analyze labor force trends by including the total labor force participation rate, the female labor force participation rate, and hiring of foreign labor.
- ***Credit and capital markets.*** We focus on financial market development, utilizing the financial markets index and the financial markets depth index.[1]

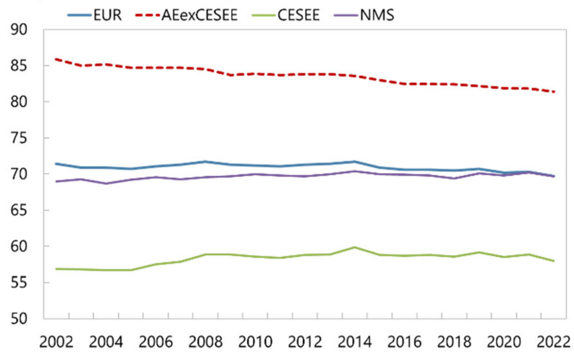
Progress with reducing structural reform gaps over the past two decades has been uneven across areas (Figure AII.1)**.** Specifically, governance gaps have persisted with little improvement, particularly in CESEE countries. Advanced economies achieved early improvements in business regulation during the 2000s (and earlier on during the 1990s) thanks to efforts in digitalizing business registration (e.g. Germany, Ireland, Luxembourg) or simplifying business start-up process through one-stop shops initiatives (e.g. Germany, United Kingdom) during the 2010s, but progress have plateaued since then. On labor market regulations, EPL has been eased in advanced economies (e.g. France, Italy, Portugal, Spain) and female labor force participation rates trended up across all country groups, as a result of changing norms but also partly due to reforms. Meanwhile, human capital indicators point to only slow improvement since the mid-2010s, with progress on the human capital index and years of schooling but greater skill mismatch. Finally, credit and capital markets show limited overall progress following extensive deregulation and deepening in the two decades prior to the Global Financial Crisis.

[1] The financial markets index measures the overall development of the financial market with a focus on the stock and bond markets.

Figure AII.1. Evolution of Structural Gap over Time

Distance to Frontier in Governance

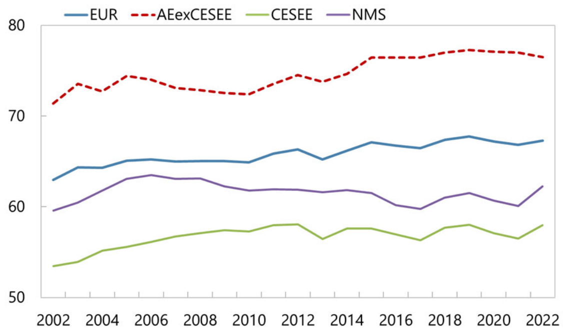
(top-2 frontier countries=100)



Sources: World Governance Indicators and IMF staff calculations.

Distance to Frontiers in Business Regulations

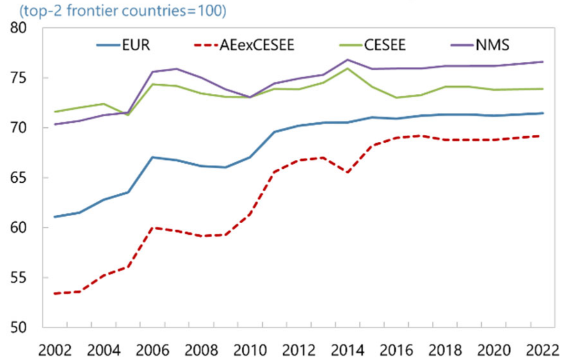
(top-2 frontier countries=100)



Sources: Fraser institute and IMF staff calculations.

Distance to Frontier in Labor Market Regulations

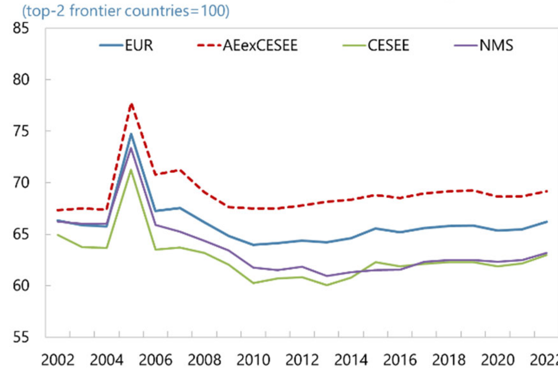
(top-2 frontier countries=100)



Source: Fraser and IMF staff calculations.

Distance to Frontier in Labor Market Participation

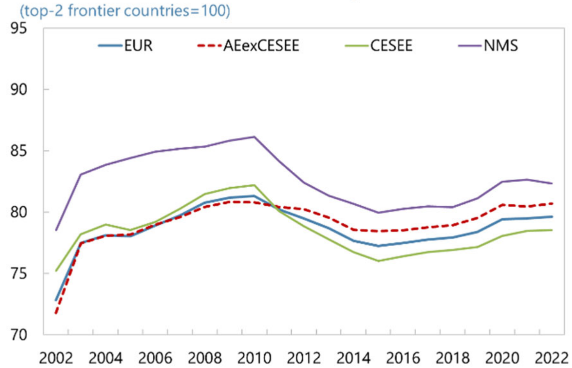
(top-2 frontier countries=100)



Source: Fraser, WB, and IMF staff calculations.

Distance to Frontier in Human Capital

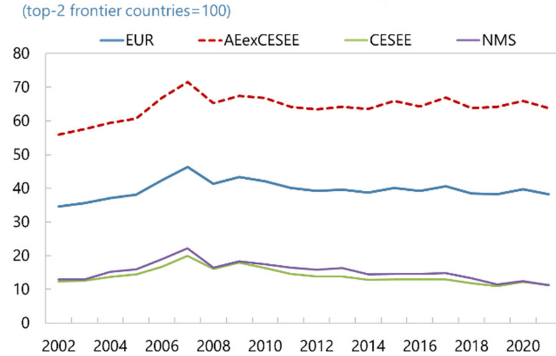
(top-2 frontier countries=100)



Source: UN, Eurostat, and IMF staff calculations.

Distance to Frontier in Credit and Capital Market

(top-2 frontier countries=100)



Sources: IMF Financial Market Index and IMF staff calculations.

Annex III: National-Level Reform Priorities in Europe: Stylized Facts

This Annex provides further details on the country-level structural reform priorities identified by IMF staff to raise medium-term potential output in Europe. Table AII.1 below summarizes the average ranking of priority areas across different regions, assigning values from 5 (highest priority) to 1 (lowest priority) for each selected reform area and 0 if the reform area is not mentioned (in cases of multiple reforms in the same area, the highest-ranked priority is used). Table AIII.2 lists priorities of broad reform areas by country.

Table AIII.1. Heat Map: Broad Priority Reform Areas by Country Groupings

	Labor and human capital	Fiscal structural	Business regulation	Governance	Innovation	Credit & capital markets	Other areas
EUR	3.5	2.5	1.9	1.5	1.3	1.1	1.1
AE ex.CESEE	3.7	2.7	2.0	0.5	1.2	1.2	1.5
CESEE	3.2	2.2	1.8	2.6	1.5	1.0	0.7
CESEE_NMS	3.7	1.6	1.6	1.5	2.4	1.1	0.4
CESEE_Non-EU	2.7	2.9	1.9	3.7	0.6	0.8	1.1

Note: Values represent average ranking of priorities in broad reform areas using the following country-level inputs: (i) priorities range from 5 (highest) to 1 (lowest); (ii) the value is zero is used if the reform area is not mentioned; (iii) in cases with multiple reforms in the same area, the highest-ranked priority is used for calculating the average. AE ex.CESEE comprises AND, AUT, BEL, CHE, CYP, DEU, DNK, ESP, FIN, FRA, GRB, GRC, IRL, ESL, ISR, ITA, LUX, MLT, NLD, NOR, PRT, SMR, and SWE. CESEE comprises 11 new member states (BGR, BIH, CZE, EST, HRV, HUN, LTU, LVA, POL, ROU, SVK, and SVN), and 10 non-EU countries (ALB, BIH, MKD, MNE, KOS, and SRB, MDA, BLR, RUS, and TUR).
Source: IMF staff's assessment.

Labor market and human capital reforms have the highest average priority ranking in all country groupings, except for non-EU CESEE economies where governance tops the list. Reforms in this area comprise 30 percent (66 reforms) of all reforms (220), with broad country coverage (43 out of 44 countries have at least one labor/human capital reform among their priorities. Labor market and human capital reforms are especially important to AEs and NMS.

While priorities are broadly focused on having the right talent participating in the labor market where it is most productive, the focus slightly varies by region. Enhancing ***education and training*** (e.g. Belgium, France, Italy), which help address ***skill mismatch*** (e.g. Austria, Greece, Norway, Sweden), and mitigating a progressively shrinking ***labor force*** (e.g. Germany, Switzerland, Netherland) are highly relevant for both AE economies and CESEE countries, while improving ***labor market flexibility*** (e.g. Belgium, San Marino, Spain) appears more prominently among AEs (Figure AIII.1). There is some heterogeneity among CESEE countries as well. Similar to AEs, NMS have a high need for labor market and human capital reforms, focusing on labor shortages (e.g. Bulgaria, Croatia, Poland), skill mismatches (e.g.

Lithuania, Estonia, Slovak Republic), and to lesser extend easing EPL (e.g. Latvia, Türkiye). On the other hand, labor reforms rank lower in the Western Balkans (WB), with reforms mainly focusing on increasing labor force participation (e.g. Moldova, Montenegro) and addressing skill mismatches (e.g. Albania, North Macedonia).

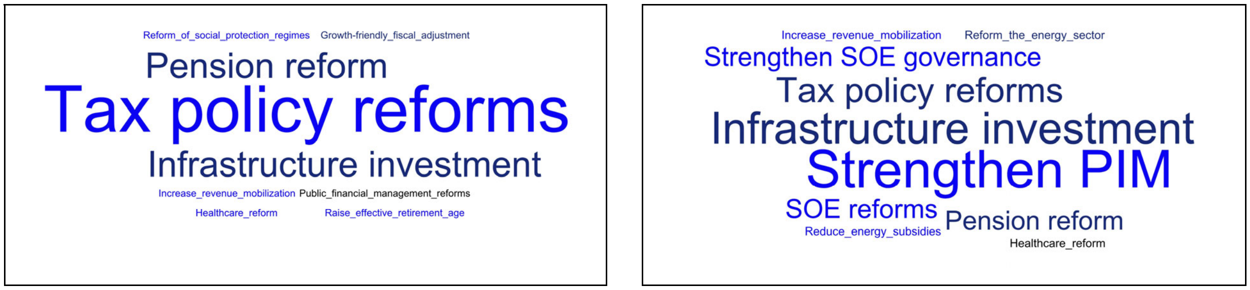
Figure AIII.1. Labor and Human Capital Reforms in AEs and CESEE Economies

Advanced economies excluding CESEE countries ***CESEE countries***

Fiscal structural reforms rank second among reform priorities in both AE economies and non-EU CESEE countries (Figure AIII.2), but with considerable variation in focus. For example, recommendations for AEs prioritize ***tax policy***, with the objectives of raising employment (i.e. reducing labor tax wedges in Belgium, Germany, Ireland, Netherland, Norway) and improving the business environment (through less progressive corporate taxation in Portugal). ***Pension system sustainability*** is also important for AEs, including through reforms that raise the early retirement age (Denmark, Norway) and/or the effective retirement age (Belgium, Luxembourg, Switzerland). Improving ***infrastructure*** is in the top-priorities list for Andorra, Germany, Ireland, Iceland, and Israel. For non-EU CESEE countries, advice instead focuses on ***SOE reforms*** (Belarus, Serbia, and Russia) and ***improving public investment***, in terms of both quantity and quality (Albania, Bosnia and Herzegovina, Moldova, North Macedonia, Russia, and Serbia). Fiscal structural reforms in CESEE NMS are comparatively less acute priorities and comprise a ***mix*** of reforms similar to those in AEs, such as pension reforms (Czech Republic, Poland), and others similar to those in the Western Balkans, such as improvements in public investment management (Bulgaria, Croatia) and SOE reforms (Romania, Croatia).

Figure AIII.2. Fiscal Structural Reforms in AEs and CESEE Economies

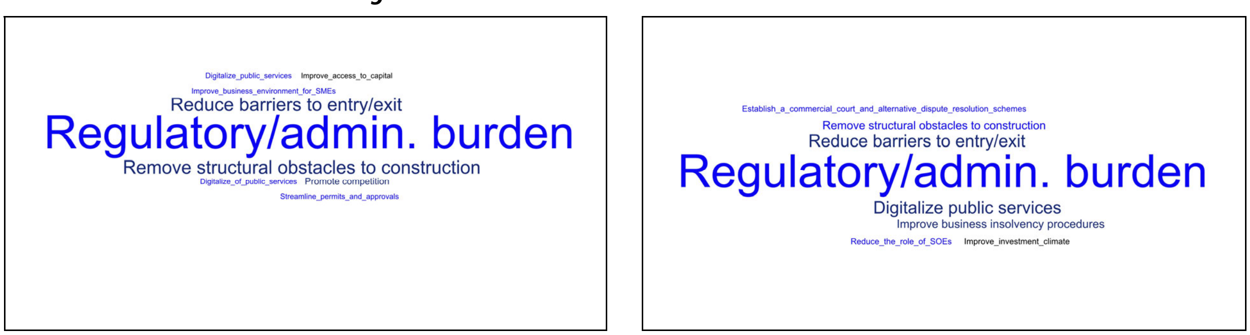
Advanced economies excluding CESEE countries ***CESEE countries***



Business (de)regulation reforms come out third in Europe due to their importance in AEs. They are included in the top-5 reform priorities in 65 percent of AE countries and 57 percent of CESEE countries, led by the Western Balkans (5 out of 6 countries), and to a lesser extent by NMS (5 out of 11) and other non-EU CESEE (2 out of 4). When taking into account its actual ranking among the top 5, business deregulation appears to be comparatively more critical for AEs compared to CESEE NMS or non-EU CESEE countries. Reducing administrative and regulatory burdens (e.g. Germany, Portugal, Slovenia), partially through digitalization of government services (e.g. Cyprus, Kosovo, North Macedonia), as well as easing product market regulation (e.g. Austria, Finland, Türkiye) and enhancing competition more broadly (e.g. Croatia, Hungary, Luxembourg), are common reform topics across all country groups (Figure AIII.3). In some AEs, reducing the stringency of spatial planning to incentivize construction of new housing and infrastructure projects (e.g. United Kingdom) is also critical.

Figure AIII.3. Business Regulation Reforms in AEs and CESEE Economies

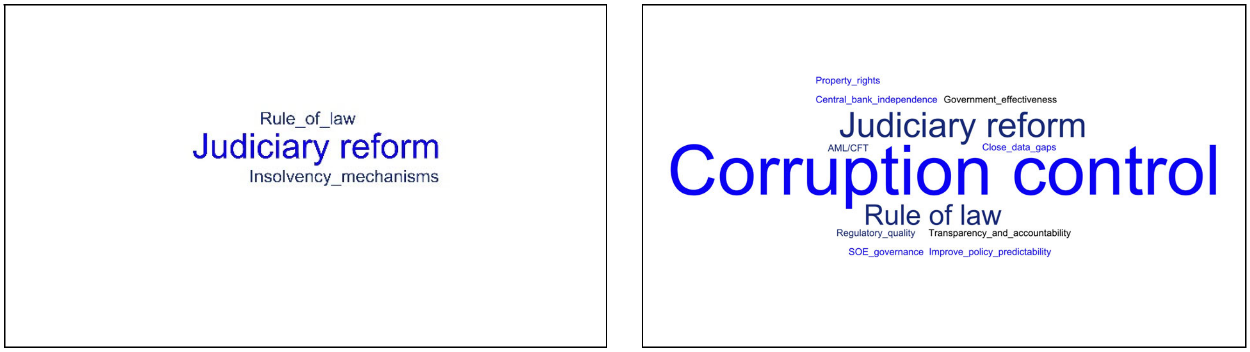
Advanced economies excluding CESEE countries ***CESEE countries***



Governance reforms are very important for CESEE economies. While only ranked fourth in terms of average priority ranking across Europe, governance reforms have the highest ranking in non-EU CESSEE countries. Tackling corruption (e.g. Bulgaria, Hungary, Moldova) and strengthening the judicial system and the rule of law (e.g. Albania, Bosnia and Herzegovina, Kosovo) are the two most widespread priorities in the CESEE group (Figure AIII.4). Judiciary reforms are also important in several AEs (Cyprus, Israel, Italy).

Figure AIII.4. Governance Reforms in AEs and CESEE Economies

Advanced economies excluding CESEE countries ***CESEE countries***



Innovation reforms, including R&D support, and digitalization have a relatively high average ranking in AEs and NMS. NMS should focus on further adoption of digital technologies in the public sector (e.g., Czech Republic, Hungary, Slovak Republic, Slovenia), supporting innovation efforts through tax incentives or direct funding (e.g., Croatia, Czech Republic, Estonia, Slovak Republic), and investing into digital infrastructure (Czech Republic, Poland) (Figure AIII.5) In AEs, priorities are on policy incentives to catalyze innovation with emphasis on enhancing the effectiveness of R&D support (e.g., Denmark, Iceland, Luxemburg, Malta, Sweden) and promoting higher digital preparedness by investing in ICT infrastructure, strengthening AI use, deepening SME digitalization, and enhancing cybersecurity (e.g., Luxembourg, Malta, the Netherlands).

Figure AIII.5. Innovation, R&D, and Digitalization Reforms in AEs and CESEE Economies

Advanced economies excluding CESEE countries ***CESEE countries***

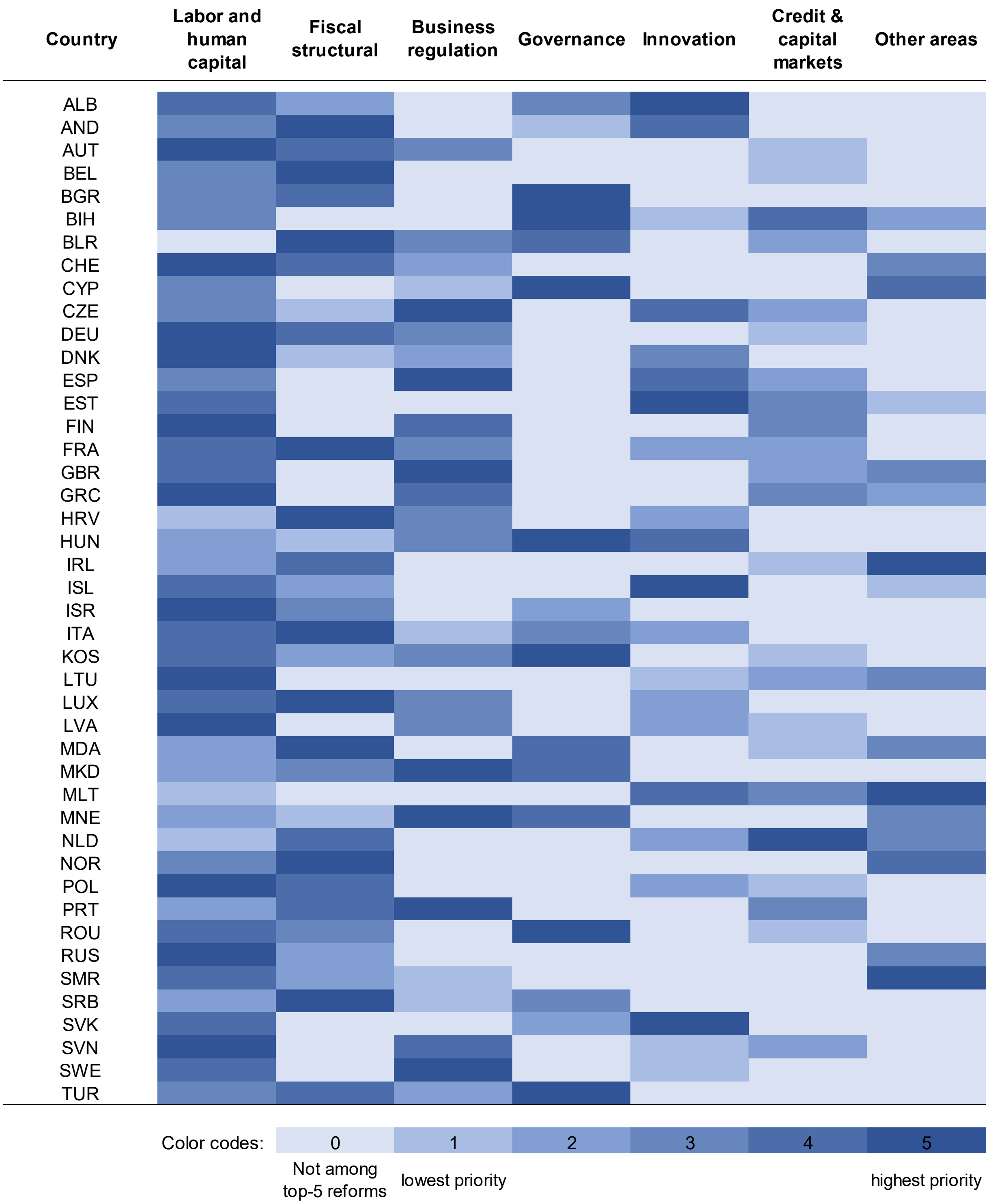
Credit and capital market reforms rank low (sixth) on average, although their importance is relatively more pronounced in AEs. These reforms feature among priorities in 23 countries, albeit with relatively lower rankings. Across the euro area, credit and capital market reforms are comparatively higher priority, although they rarely feature in the top-5 list in part because progress in this area rests predominantly on further steps towards completing the CMU at the EU level. Most frequently cited reforms include financing for innovation and improving access to finance for SMEs (Figure AIII. 6). For AEs, priorities lean slightly more toward developing risk capital financing and venture capital (Austria, Belgium, Germany, Finland). For CESEE, the focus is on SME finance more broadly, through both risk capital financing (e.g. Latvia, Czech Republic, Poland) and easing financial conditions (e.g. Lithuania, Romania, Slovenia).

Figure AIII.6. Credit and Capital Market Reforms in AEs and CESEE Economies

Advanced economies excluding CESEE countries ***CESEE countries***

The list of reform recommendations also includes 18 other priorities in the energy sector and housing market areas. Most (13 reforms) apply to AEs. Examples include energy sector reforms for Malta, Norway, and Cyprus; green transition policies in the Netherlands, Estonia, Switzerland, and Iceland; and easing constraints in housing supply and housing ownership in Ireland and San Marino.

Table AIII.2. Heat Map: Broad Priority Reform Areas



Note: Values represent average rankings of priorities in broad reform areas using the following country-level inputs: (i) priorities range from 5 (highest) to 1 (lowest), (ii) the value is zero is used if the reform area is not among top-5 priorities.
Source: IMF staff's assessment.

Annex IV. Quantifying the Output Gains from Reforms

We employ a stylized quantification framework to assess the medium-term (5-year) output gains of prioritized reforms. For quantifiable reforms, we consider two key inputs: the size of the structural policy gap to be closed (relative to the frontier) and the medium-term output (5-year ahead) elasticity of each reform. In essence, the medium-term output effect of a reform is the product of the size of the policy gap assumed to be closed and the corresponding output elasticity. We simulate am ambitious scenario where countries aim to close 50 percent of their policy gaps with respect to the frontier in each of their top-5 reform priority areas.

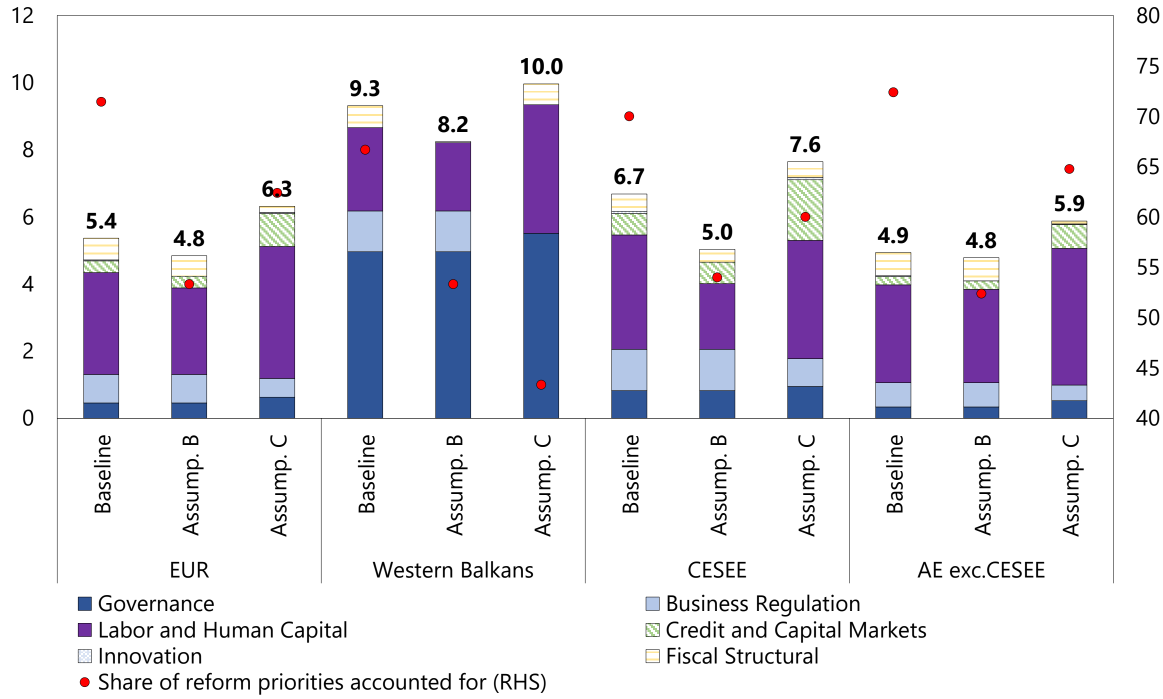
To determine the output elasticities, we utilize estimates from various IMF studies on governance, business regulations, labor markets, innovation, and fiscal reforms. In cases where elasticities are unavailable, we apply growth accounting to quantify the potential output gains. To the greatest extent possible, we consider budget-neutral reforms in fiscal areas. The results primarily based on IMF studies are complemented by additional empirical findings from the OECD (Égert, 2017; Égert and Gal, 2017), providing a range of estimates.

We use multiple approaches to quantify as many reforms as possible. Each specific reform priority is mapped to the most relevant structural indicator (when available), and the policy gap is calculated. We quantify output gains using either only prior IMF work (Assumption B), prior OECD work (Assumption C), or both combined (Baseline). The latter option is the focus of the main text as it maximizes the fraction of reform priorities whose effects can quantified; the IMF estimate was used when available, and otherwise the OECD estimate was applied. Reliance on both IMF and OECD estimates of reform gains also has the benefit of providing a range of estimates and a cross-check.

Potential reform gains are sizeable across throughout Europe, but even more so for countries farther away from the frontier. Implementing all prioritized reforms could lift the level of GDP in the medium term by about 8-10 percent to GDP in the Western Balkans, followed by 5-8 percent in the CESEE region and 5-6 percent in AEs excluding advanced CESEE economies (Figure AIV.1). These estimated regional output gains are affected by the shares of prioritized reforms that could be quantified—a source of under-estimation, all else equal. Depending on the scenario, 43-67 percent of prioritized reforms are covered by the quantification exercise for the Western Balkans (WB), compared to 54-70 percent for CESEE and 52-72 percent for AEs.

These estimates are subject to important caveats and should be seen as illustrative. They assume common output elasticities across all countries and, as such, do not account for country-specific characteristics that theory and evidence suggest are likely to shape the output effects of reforms. In addition, as discussed in the main text, there are potential sources of both under- and over-estimation of the reform impacts produced by this exercise, over and above the limitations of, and uncertainty surrounding the effects obtained in, the underlying empirical studies.

Figure AIV.1. Europe: Medium-term GDP Gain from Closing 50 Percent of Prioritized Policy Gaps *(Percent)*



Sources: IMF; OECD; IMF staff calculations.
Note: The estimated GDP impact of each reform in a region is the GDP-weighted regional average. The estimates that underpin the baseline scenario combine prior IMF work (Assumption B) with OECD results (Assumption C) to maximize reform coverage. The Western Balkans include Albania, Bosnia and Herzegovina, Kosovo, Montenegro and North Macedonia. CESEE excludes Russia and Ukraine. AE excludes advanced CESEE countries and San Marino.

Table AIV.1 Europe: Policy Changes and Output Impact Estimates

Sector	Source, definition	Source, definition	Elasticity: Source	Elasticity: Group	Elasticity: Size	50 Percent of Policy Gaps	Sign of pro-reform measure	Baseline: GDP Impact	Baseline: # of Reforms	Assumption B: GDP Impact	Assumption B: # of Reforms	Assumption C: GDP Impact	Assumption C: # of Reforms
Business Regulations	ETCR indicator - overall	OECD Product Market Regulation Indicator for Energy, Transport and Communication sectors; 0-6, 6 is	Duval and Furceri, 2018 IMF SDN 2023 on Reforms	AE EM	0.025 0.025	**-0.437**	-	0.79	17	0.79	17	0.55	17
	PMR - barriers to trade and investment	OECD Product Market Regulation database, 0-6, 6 is strictest.	Duval and Furceri, 2018 IMF SDN 2023 on Reforms	AE EM	0.025 0.025	**-0.276**	-	0.06	8	0.06	8	...	...
Innovation	Business sector R&D as a % of GDP	OECD Research and Development Statistics (RDS); R&D in the business sector funded by the business sector.	OECD	AE, EM	0.008	**0.618**	+	0.03	11	...	...	0.03	11
Governance	Control of corruption	World Bank, World Governnance Indicators; higher values indicate less	IMF SDN 2023 on Reforms	AE EM	0.026 0.036	**1.216**	+	0.46	14	0.46	14	0.63	14
Labor and Human Capital	EPL - permanent contracts	OECD Indicators of Employment Protection, 0-6, 6 is strictest.	Duval and Furceri, 2018	AE, EM	0.003	**-0.127**	-	0.01	5	0.01	5	0.09	5
	ALMP spending	OECD Indicators of Labour Market Programmes; Spending on active labour market policies, per unemployed, as a % of GDP per capita.	IMF April 2016 WEO CH 3	AE, EM	0.003	**11.484**	+	0.51	9	0.51	9	0.25	9
	Excess coverage	Excess coverage fo wage bargaining, difference between bargaining coverage and union coverage.	OECD	AE	0.007	**-1.931**	-	0.00	1	...	...	0.00	1
	Tax wedge: couple, single earnier, 2 children	OECD Tax Statistics	IMF April 2016 WEO CH 3	AE, EM	0.004	**-10.145**	-	0.21	5	0.21	5	0.13	5
	Family benefits in kind (spending as % GDP)	OECD Family Database; Government spending on family benefits, in kind, % of GDP.	OECD	AE, EM	0.033	**1.000**	+	0.31	1	...	...	0.31	1
	Labor force participation, total, 15+	World Bank; % of total population ages 15+, national estimate.	Growth accounting			**8.057**	+	1.55	12	1.55	12	2.66	12
	Labor force participation, female, 15+	World Bank; % of female population ages 15+, national estimate.	Growth accounting			**10.253**	+	0.29	4	0.29	4	0.34	4
	Pisa score	OECD; average of mathematics, reading, and science scores.	OECD	AE, EM	0.011	**20.950**	+	0.06	10	...	...	0.06	10
	Human capital index	UNDP;	OECD	AE, EM	0.094	**0.057**	+	0.09	12	...	...	0.09	12
Credit and Capital Markets	Financial Markets Depth Index	IMF; index rating; 0-1, higher values indicate better performance.	MF 2019 WEO CH 3	AE, EM	0.035	**0.288**		0.35	18	0.35	18	0.98	18
Fiscal Structural	Legal retirement age	OECD Economic Outlook; simple average of female and male pension ages.	OECD	AE, EM	0.006	**1.607**	+	0.15	9	0.15	9	0.15	9
	Infrastructure spending	IMF, Haver; General Government gross fixed capital formation.	IMF Apr. 2020 Fiscal Monitor CH 2	AE, EM	0.600	**0.950**	+	0.19	7	0.19	7	...	...
	Direct taxes	IMF; PIT, CIT and social security contributions, % of GDP.	Acosta-Ormaechea and Yoo, 2012	AE, EM	0.065	**-5.846**	+	0.28	4	0.28	4	...	...
	ETCR indicator - public ownership	OECD Product Market Regulation Indicator: State ownership in Energy, Transport and Communication sectors; 0-6, 6 is strictest.	OECD	AE, EM	0.010	**-1.017**	-	0.03	3	...	...	0.03	3
	Total							**5.37**	**150**	**4.85**	**112**	**6.31**	**131**
	Share of reforms priorities accounted for								**71**		**53**		**62**

Source: Fraser Institute; OECD; GTA; Berkeley; IMF; Eurostat; World Bank; UNDP; and IMF staff calculations.

1/ The estimated GDP impact of each reform in a region is the regional weighted average. The baseline scenario estimates combine prior IMF work (Assumptions B) with OECD results (Assumptions C) to

2/ Typical policy changes is computed as average change over a 2-year window when the policy indicator moves in a direction favourable to potential output in both years.

PUBLICATIONS

Europe’s National-Level Structural Reform Priorities

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