



# The political economy of structural reform

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## Why focus on PESR?

- Sentiment that there is consensus about the diagnosis/prescriptions but lack of ability to implement
- Do not oversell:
  - Lagging implementation may often reflect disagreement on objectives
  - Crisis may weaken consensus
- In any case, OECD work programme on PESR since 2005

# Approaches to study PESR

- Econometric approaches
  - combining information across OECD countries, time and different structural policy areas
  - Aiming to explain either
    - Progress in structural policy as represented by indicators of policy stance
    - Probability of major reforms taking place (identified as “large” changes in indicators of policy stance)
  - Explanatory variables covering economic conditions, macroeconomic policy, political institutions, international environment, demography, interactions across policy areas, etc.

# Approaches to study PESR

- Case studies
  - 20 episodes of attempts at reform
    - 2 cases for each of 10 countries
    - Restricted to 3 broad policy areas: product markets, labour markets and retirement policies
    - one broadly successful and one broadly unsuccessful
      - Note: reality proved a lot more nuanced
    - Based on the literature, large numbers of direct interviews with people involved
    - Applying an approach of “focused comparison”, posing the same questions, covering the same bases across countries

## Pros and cons of different approaches

- **Econometric approaches**
  - Pro: statistical rigour, degrees of freedom to identify influences
  - Con: only quantifiable influences covered, soft/political issues cannot be covered
- **Case studies**
  - Pro: richer coverage of context, ability to deal with process
  - Con: essentially judgemental, only reform attempts covered, symmetric case selection (success/failure) excludes role of country-specifics such as political system

# Overview of results

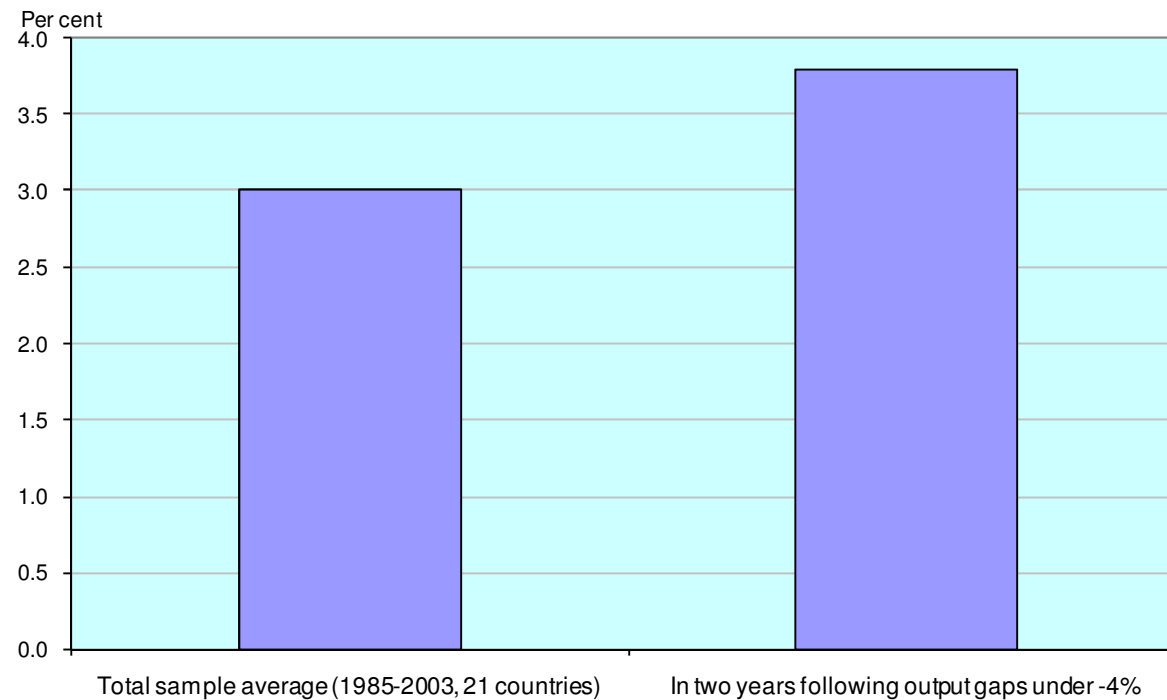
- Role of macroeconomic conditions and policies
- Role of “exogenous” factors
- Interactions, sequencing and timing of reforms
- Political process
- Dealing with winners and losers

# Macroeconomic conditions and policies

- Recessions/crises are good for reform [SLIDE]
- The role of unemployment is ambiguous
  - Little effect on average, good for major reforms, inconsistent effects at a detailed level
- Healthy government finances are good for reform and on-going consolidation is bad
  - Ability to compensate losers
  - Ability to accommodate demand weakness in the wake of major reform
- Monetary and exchange rate policy
  - Conflicting arguments: TINA vs. ability to accommodate
  - Unclear empirical evidence: some signs that a fixed ER (single currency?) reduces the probability of major reform

# Downturns lead to progress in labour and product market reform

(Annual percentage reduction in structural rigidity index)



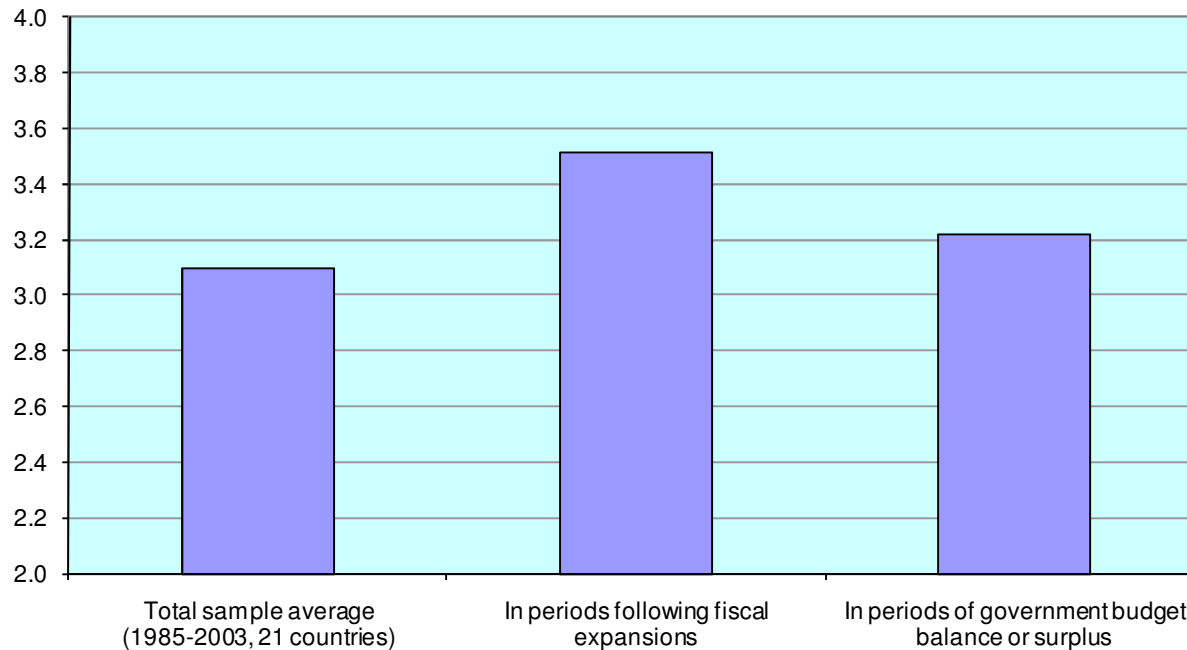


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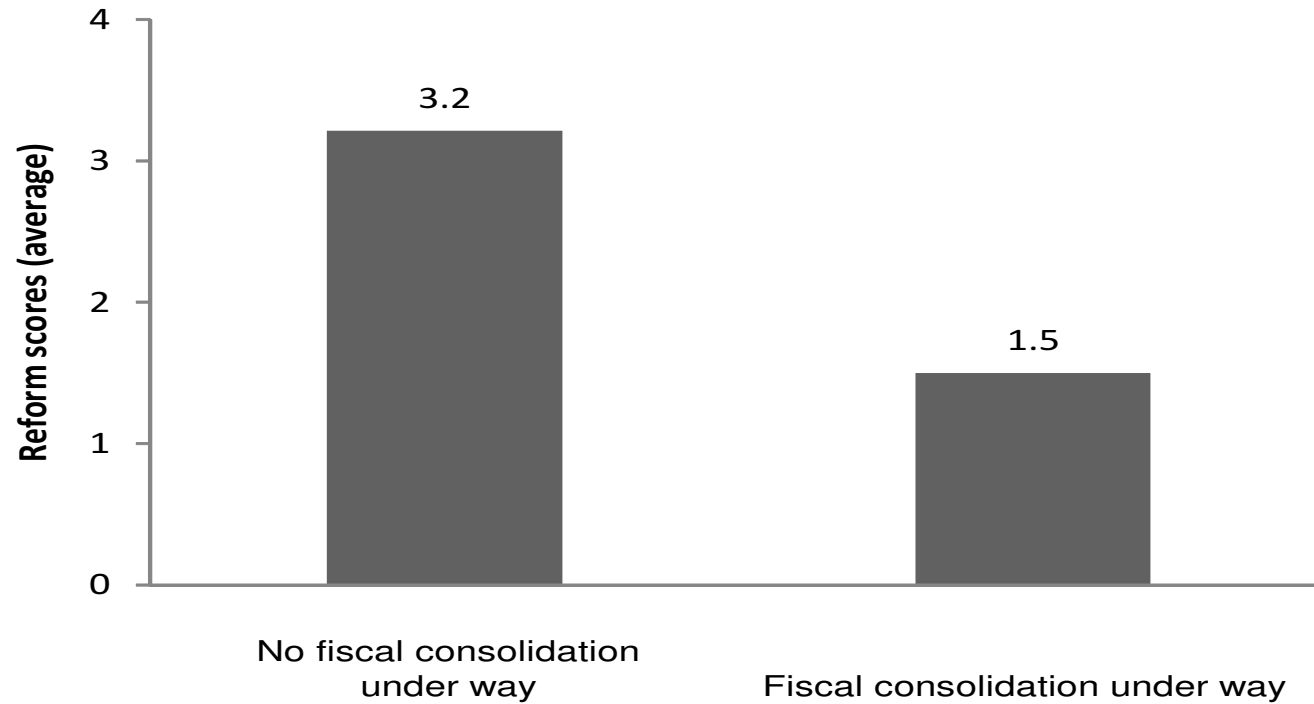
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# Fiscal policy and progress in labour and product market reform

Annual percentage change in synthetic indicator of labour and product market policy



# Reform score and fiscal consolidation



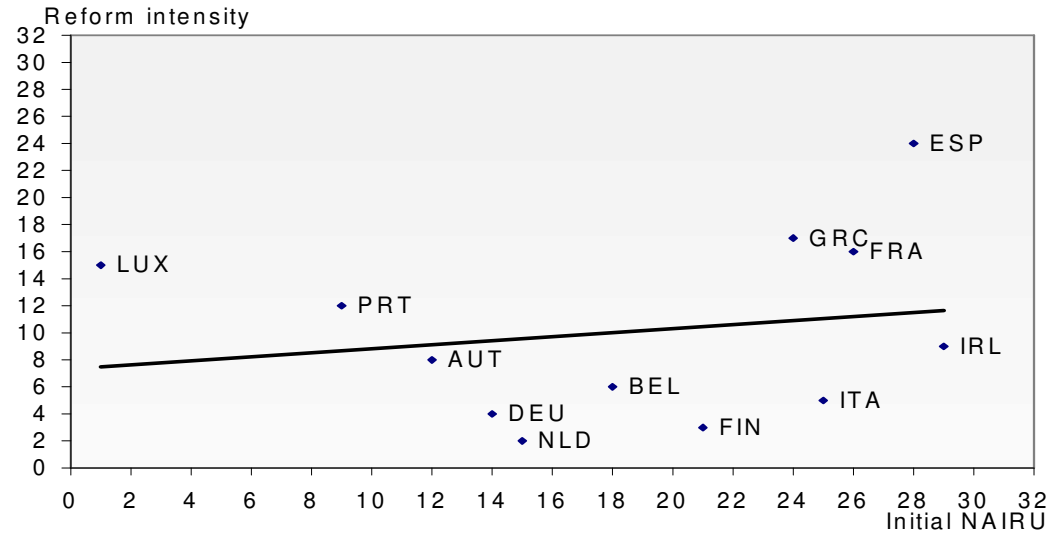
Source: Case studies.

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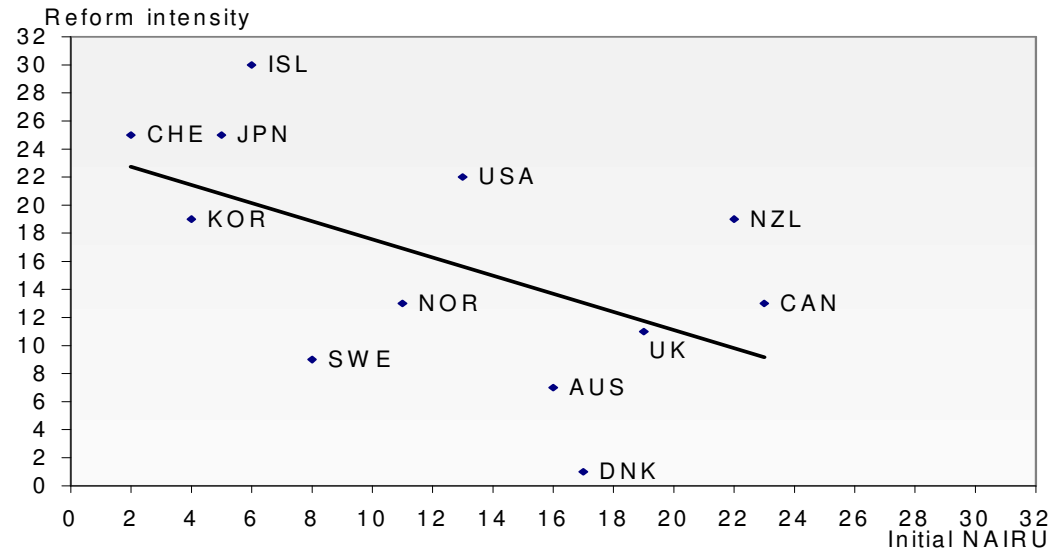
**Initial conditions and intensity of labour market reforms over 1994-2004**

**Ranks of initial NAIUs and ranks of reform intensities: EMU countries**



(Spearman's rank) correlation coefficient: 0.19

**Ranks of initial NAIUs and ranks of reform intensities: non-EMU countries**

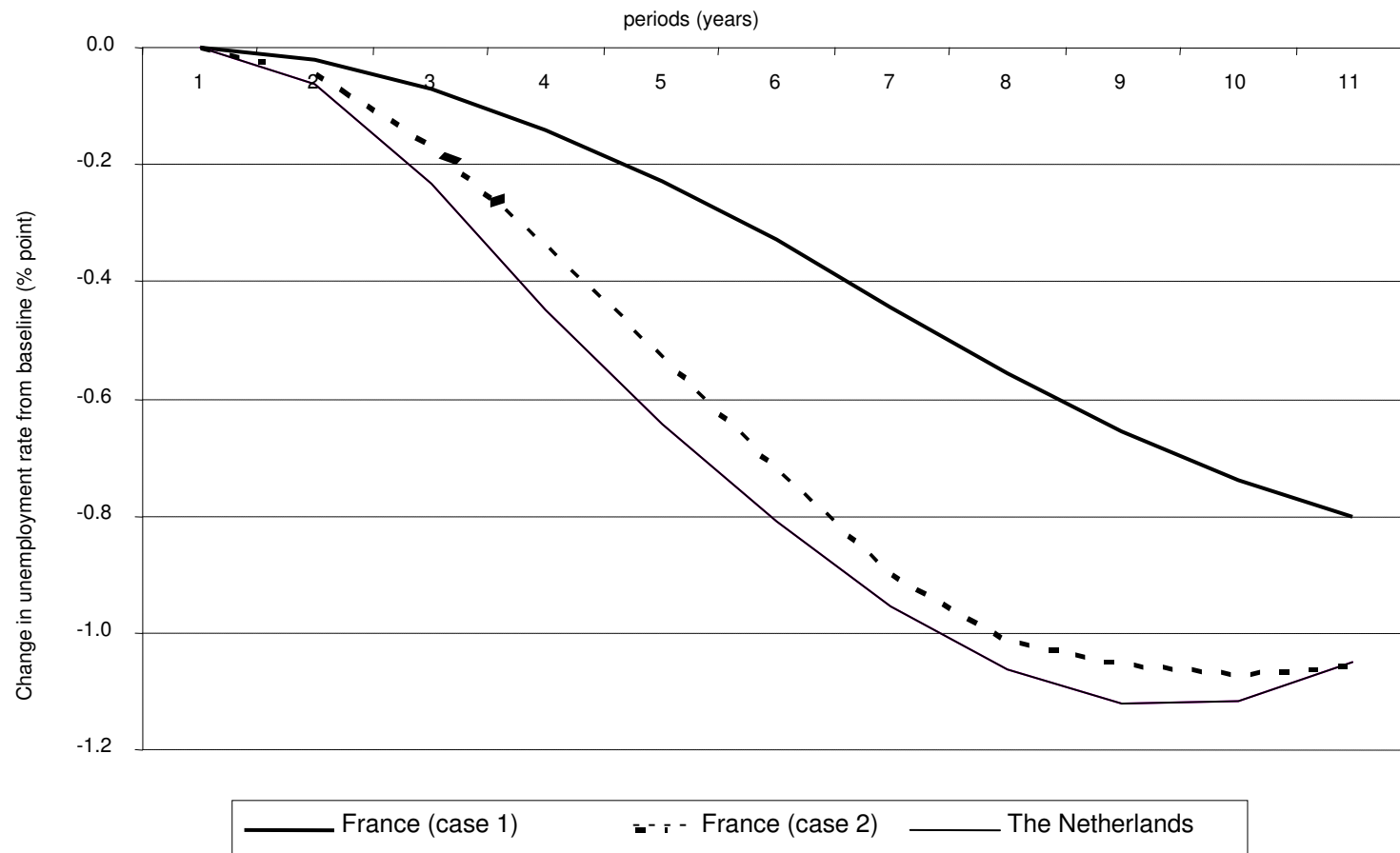


(Spearman's rank) correlation coefficient: -0.55 \*

## Role of “exogenous” factors

- Small countries may undertake major reform more easily
  - Homogeneity of population?
  - External trade as a shock absorber? [SLIDE]
- Ageing may not lead to greater conservatism
- International influences affect reform
  - EU membership, Single Market, reforms in trading partners, trade liberalisation tend to boost domestic product market reform (with ambiguous effects on labour markets). Confirmed in case studies.

# Simulated unemployment adjustment to drop in the NAIRU



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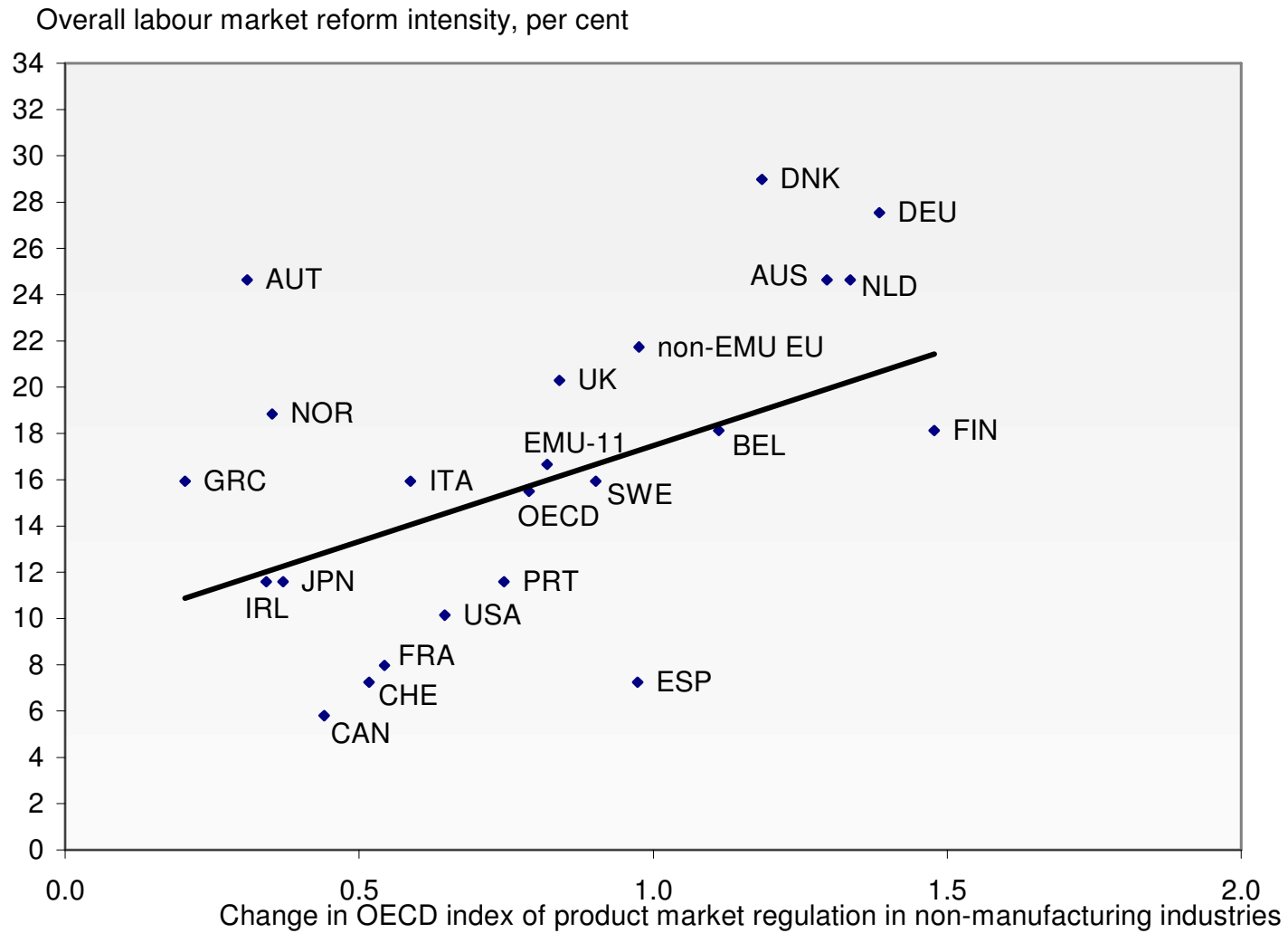
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# Interactions, sequencing and timing of reform 1

- There is a pattern of sequencing running from “external side” over domestic product markets to labour markets
  - May reflect competitive pressures and rent destruction [SLIDE]
- Whether “bundled” or not, individual reforms tend to be easier to advance against the backdrop of *a broad on-going reform process*.
- *More haste can make for less speed*: complex reforms take time to design and adopt, as well as to bear fruit.

### Changes in product market regulation over 1993-1998 and intensity of labour market reforms over 1999-2004\*

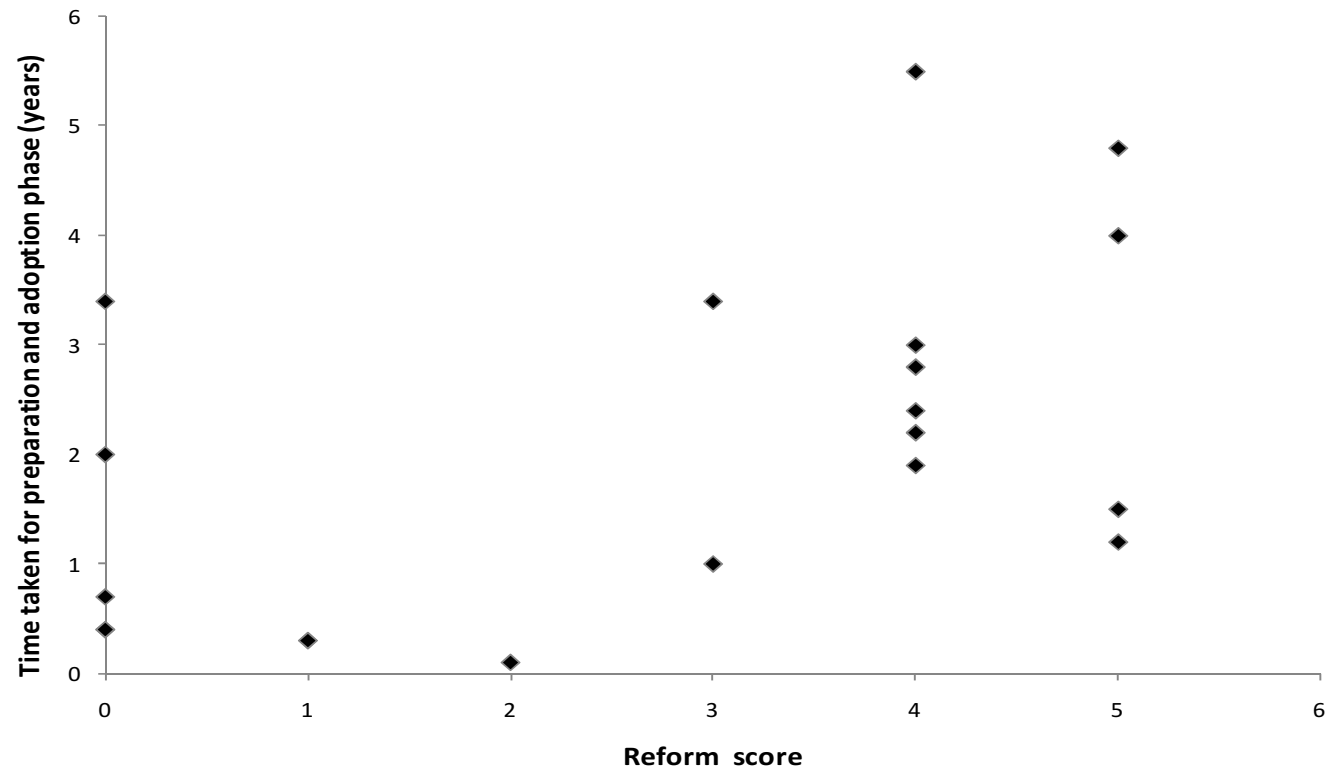


Correlation coefficient: 0.40  
 t-statistics 1.91 \*

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[SLIDE]

# Reform score and speed of reform

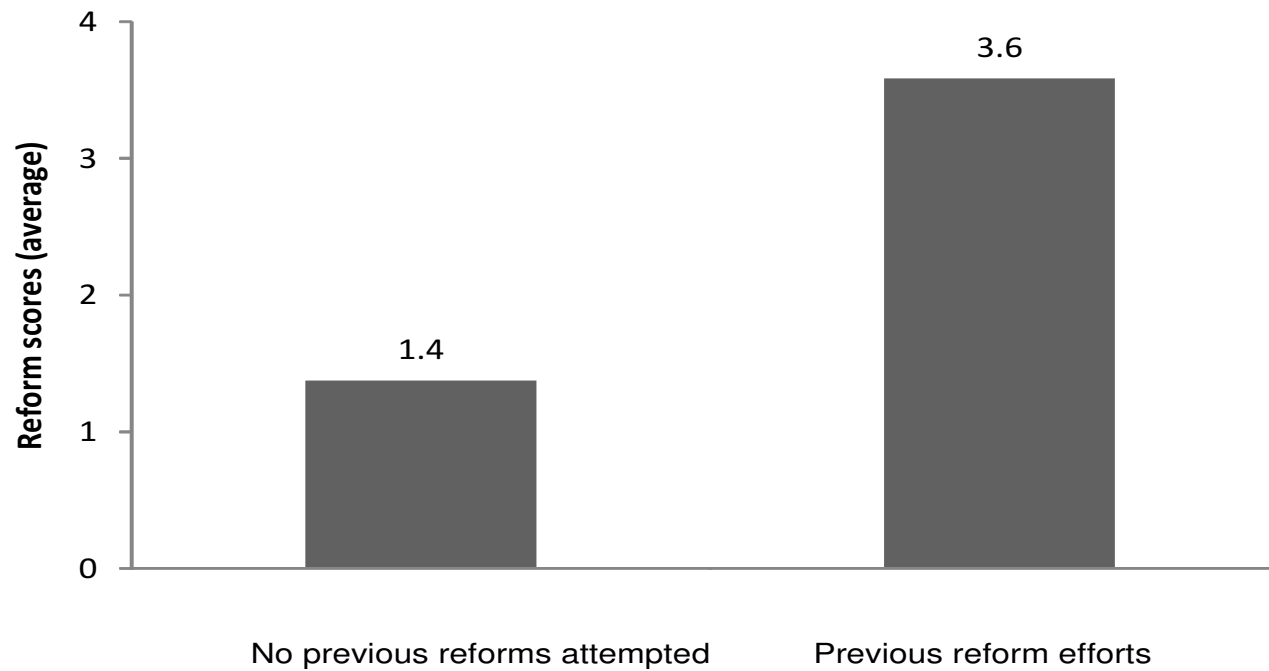


Source: Case studies.

## Interactions, sequencing and timing of reform 2

- *Delay* can raise the cost of reform, but reform can be harder if a policy regime is not “ripe” for change.
- *Limited early reforms* can generate momentum for further reform. [SLIDE]
- Where elements of a reform are to be implemented with a delay, it helps to render them as “*automatic*” as possible.

# Reform scores and reform history



Source: case studies.

## Interactions, sequencing and timing of reform 2

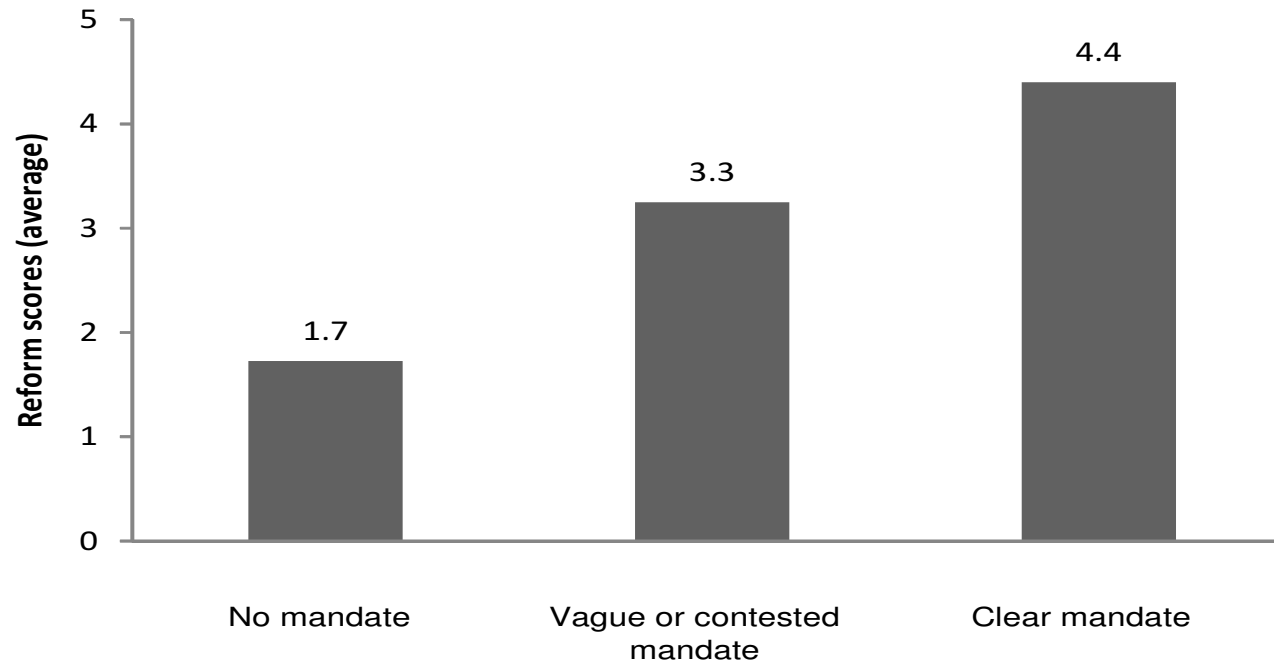
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# Political process 1

- *Electoral mandates* matter (particularly for pension and EPL reforms). “Reform by stealth” is rarely a promising strategy.[SLIDE]
- The *electoral cycle* appears to give newly elected governments an opportunity (most clear for labour-market reforms, least for pension reforms). But regression analysis finds more progress under mature government – possibly reflecting implementation lags.
- Government *cohesion* is key: it appears to matter more than the size of a government’s majority or the state of the opposition.
- “*Ownership*” of reforms is important: reform “orphans” are rarely successful.



# Reform mandates and reform score



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## Political process 2

- In general, the government's *ideological orientation* seems to matter little for the success of reform, though labour-market reform may be easier under a government of the left – sometimes it may “take a Nixon to go to China”. But regression analysis suggests that less labour market reform is done under left-wing governments.
- There is little to support the view of *sub-national governments* as less reform-oriented than national governments, but neither are they always more reformist: the question of when and where decentralisation aids reform is highly issue- and context-dependent.

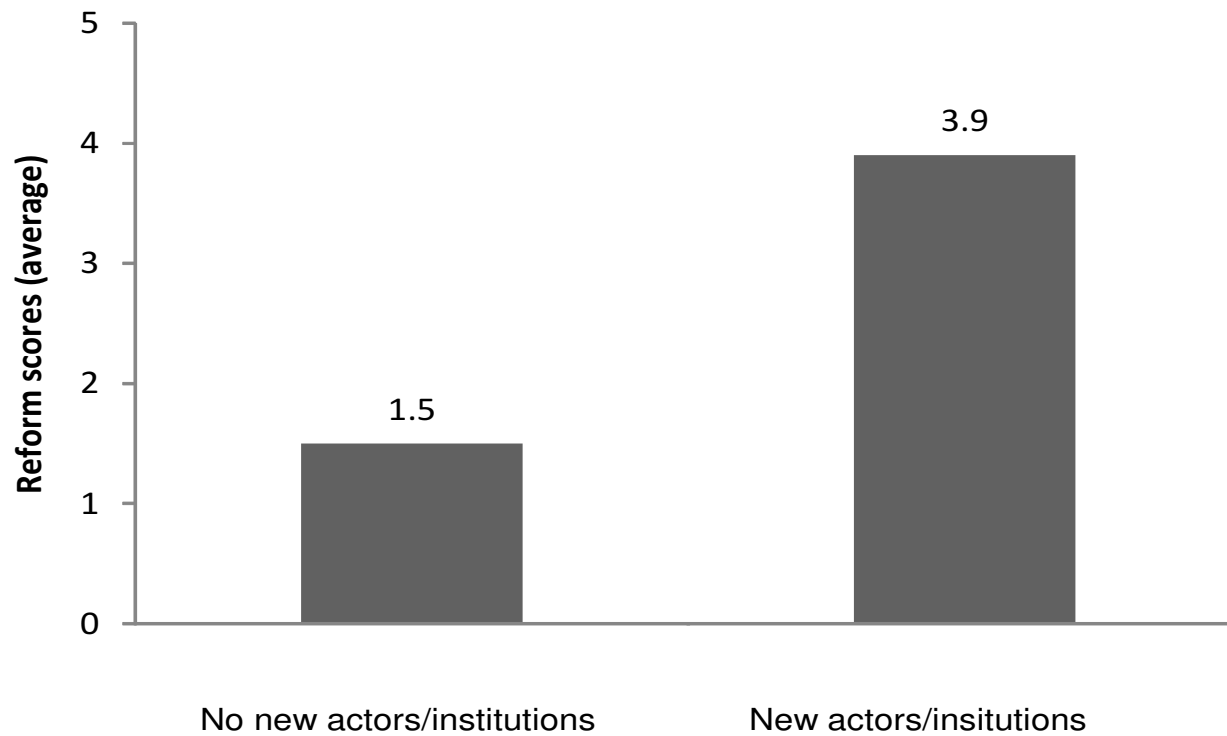
## Communication, consultation and analysis

- Effective *communication* is critical, particularly for pension and EPL reforms.
- Public understanding of the costs of the *status quo* is often critical – and can be difficult to achieve when these are opportunity costs.
- Good and credible *analysis* of the costs of inaction/gains from reform is often crucial. Specialised “*reform institutions*” can be helpful in this regard.
- *Concertation* can have its advantages but also disadvantages.

## Dealing with winners and losers

- *Involving potential opponents* may facilitate adoption of reforms – but at a price.
- Creating “*early winners*” or *new actors and institutions* early in the course of a reform can help to sustain the momentum behind it. [SLIDE]
- “*Acquired rights*” cannot easily be violated. Often this requires exempting some groups from the reform, but this is not always feasible.
- *Potential losers* are more likely to mobilise than potential winners, except in the case of some product-market reforms.
- Resistance tends to increase with the “*political cost-benefit ratio*” – the relationship between a reform’s redistributive impact and the efficiency gains it yields. This can be especially important when reforming product markets.

# Reform score and emergence of new actors



Source: case studies.

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