

# OECD FORUM 2007

## IMPLEMENTING STRUCTURAL REFORM

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**G**overnments throughout the OECD are committed to strengthen growth, employment and public finances. That the pursuit of these objectives requires in many countries extensive structural reform is also broadly recognised. Yet, progress has been uneven across both countries and policy fields. One reason for this arises from possible trade-offs with worthwhile non-economic objectives. However, differences in the depth, scope and timing of reform also reflect political constraints. Because reforms do not only increase overall welfare but also tend to alter its distribution across society, it has proved difficult to generate the necessary pro-reform consensus in the electorate. Better understanding the factors behind resistance to reform and finding the ways to overcome it are at the core of a new area for research, the so-called “political economy of structural reforms”, a field that the OECD has recently investigated in some depth.

**T**hese political economy issues are the subject of a special chapter of the 2007 edition of *Going for Growth*, which provides a brief review of reform patterns in OECD countries before taking stock of recent OECD research on the way in which economic and political conditions can affect the course of reform in product and labour markets. The chapter then draws some conclusions on the reform strategies that could improve the chances of successfully implementing growth-enhancing policies.

### The bumpy road to structural reform

**P**rogress in structural reform has been achieved in OECD countries over the past two decades. Over this period, the sequencing of reforms has generally seen reforms of trade, foreign direct investment and financial markets precede domestic product market reforms. Moreover, product market reforms have often preceded labour market reforms. However, reform progress has been unevenly distributed across countries and policy fields.

### Reform strategies

**T**he review of the evidence on factors affecting structural reform implementation points to some tentative lessons, positive and negative, that can be learnt from the past experience with economic reform highlighted by OECD surveillance processes.

**F**irst of all, the fact that opposition to reform is often grounded on complexities related to the costs and benefits of policy changes and the trade-offs between economic and other objectives suggests that comprehensive and transparent explanations are essential elements of successful structural reforms. The various stakeholders should have a clear understanding of the problems and of the solutions – including the involved costs and benefits – in both the short and the long run. To this end, use of outside expertise may bolster the case for structural reform.

**S**econdly, the role of supportive macroeconomic policies should be recognised. Macroeconomic policies designed to keep aggregate demand close to potential output may facilitate the conduct of structural reforms by minimising the fear that structural change could be associated with deficient aggregate demand. In countries with domestic monetary anchors, it may be worth increasing awareness that if such shortfalls in demand were to result from structural reform, they will not be left to linger. In countries which participate in a monetary union, it may be considered whether there exist co-ordinated approaches to structural reform that would allow monetary accommodation consistent with price stability. Completion of the EU internal market is one case in point.

On the fiscal policy side, sound public finances are likely to create the wherewithal required for the introduction of some structural reforms, by providing confidence and room for manoeuvre. In countries where fiscal deficits are substantial, the necessary consolidation could complicate the course of reform in the short run but will ultimately help to create scope for macroeconomic accommodation or for transitional policies aimed at buffering the temporary costs of reform for stakeholders.

**T**hirdly, sequencing and synergies between structural policies may significantly facilitate reform. Internationally co-ordinated approaches to product market reform at or inside borders appear to have been successful historically and to be able to generate momentum for further reforms. Obvious opportunities to pursue this route would be a reanimation of the currently stalled Doha Round and a rapid and effective implementation of the internal EU market for services. Further opening of borders and more extensive liberalisation of product markets within countries may also pave the way for labour market reforms. However, it has to be recognised that much of the low-hanging fruit has been picked in product markets and that reforms in those service sectors (including utilities) that remain heavily regulated will not be easy, partly because of the related labour market dimension.

In labour markets, the limitations associated with changes that are both strong and concentrating on the margins of the market have become increasingly clear in a number of OECD countries. For instance, experience suggests that selective easing of employment protection legislation focusing on workers weakly attached to the labour force is unlikely to lead to more comprehensive reforms. Rather, the resulting labour market duality generally spurs opposition to further marginal reforms.

The need for reforms establishing a common set of rules for shaping the career profiles and the mobility of workers without constraining job turnover is therefore more obvious. Several OECD countries were able to implement reforms of this kind, such as Austria in the area of hiring and firing rules and a number of other OECD countries in the area of unemployment insurance. The political viability of such reforms often hinges on the possibility to “grandfather” the initial rights of stakeholders during the transition to the new labour market environment.

(Extract from Chapter 7, “What Shapes the Implementation of Structural Reform,” *Going for Growth*, OECD 2007)