



# The Political Economy of Reform

Lessons from pensions,  
product markets and labour  
markets in ten OECD  
countries

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## The primary aim of the study...

- .....is to identify political economy lessons that may be of use to policy-makers seeking to design, adopt and implement structural reforms.
- Previous work by the OECD and numerous other institutions and researchers usually econometric: doesn't always lead to practical policy implications (crises?).

## An inductive approach...

- .....based on country case studies of more and less successful *attempts* to adopt and implement structural reforms. The cases focus on what was adopted and implemented (or not) and why – not primarily on the effects of reform
- Three areas: product markets, labour markets, pension reform.

# Case studies

Retirement reforms	Labour market reforms	Product-market reforms
<p><b>France:</b> the 2003 pension reform.</p> <p><b>Mexico:</b> reform of the pensions system for federal employees in 2007.</p> <p><b>Poland:</b> the transition from an unreformed PAYG system to a three-tier system in 1997–99.</p> <p><b>Italy:</b> the government’s attempt to reform the pension system in late 1994.</p> <p><b>United States:</b> the administration’s 2005 proposals for social security reform.</p> <p><b>Poland:</b> the attempt to reform the farmers’ social security scheme (KRUS), 2003–05.</p>	<p><b>United States:</b> the “PRWORA” welfare reform legislation of 1996.</p> <p><b>The Netherlands:</b> reform of disability insurance, 2002-06.</p> <p><b>Italy:</b> the Treu (1997) and Biagi (2003) reforms.</p> <p><b>Spain:</b> labour market reforms of 1994 and 1997.</p> <p><b>Germany:</b> the Hartz reforms (2002–05).</p> <p><b>France:</b> the <i>contrat d'insertion professionnelle</i> in 1993–94.</p> <p><b>Mexico:</b> proposed reform of the labour law, advanced in 2002 but withdrawn in 2005.</p> <p><b>Sweden:</b> Reform of sickness benefit, 1991-2002.</p>	<p><b>Australia:</b> power-sector reform, 1990-2004.</p> <p><b>Sweden:</b> postal reform, 1992–2000.</p> <p><b>Germany:</b> drive to liberalise shop opening hours, 1999-2004.</p> <p><b>Australia:</b> water reform, 1994–2004.</p> <p><b>Spain:</b> attempts to open up the retail sector, 1995-2004.</p> <p><b>Netherlands:</b> proposals for partial, phased rent deregulation, 2004-07.</p>

# Three important caveats

1. These lessons are based on a limited number of cases and therefore may not be generalisable. However, many are consistent with the findings of previous research.
2. The project focuses on reforms *attempted*.
  - Results therefore do *not* tell us what prompts reform attempts, but
  - they *do* cast light on how different reform drivers may affect prospects for adoption and implementation.
3. The cases focus on what was adopted and implemented (or not) and why – not primarily on the effects of reform.

# Political context

- *Electoral mandates* matter, particularly for pension and EPL reforms. “Reform by stealth” is rarely a promising strategy.
- The electoral *cycle* appears most closely linked to labour-market reforms and is least salient for pension reforms.
- Government *cohesion* is key: it appears to matter more than the size of a government’s majority or the state of the opposition.
- In general, the government’s *ideological orientation* seems to matter little, though labour-market reform may be easier under a government of the left – sometimes it may “take a Nixon to go to China”.
- 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.

# Economic factors

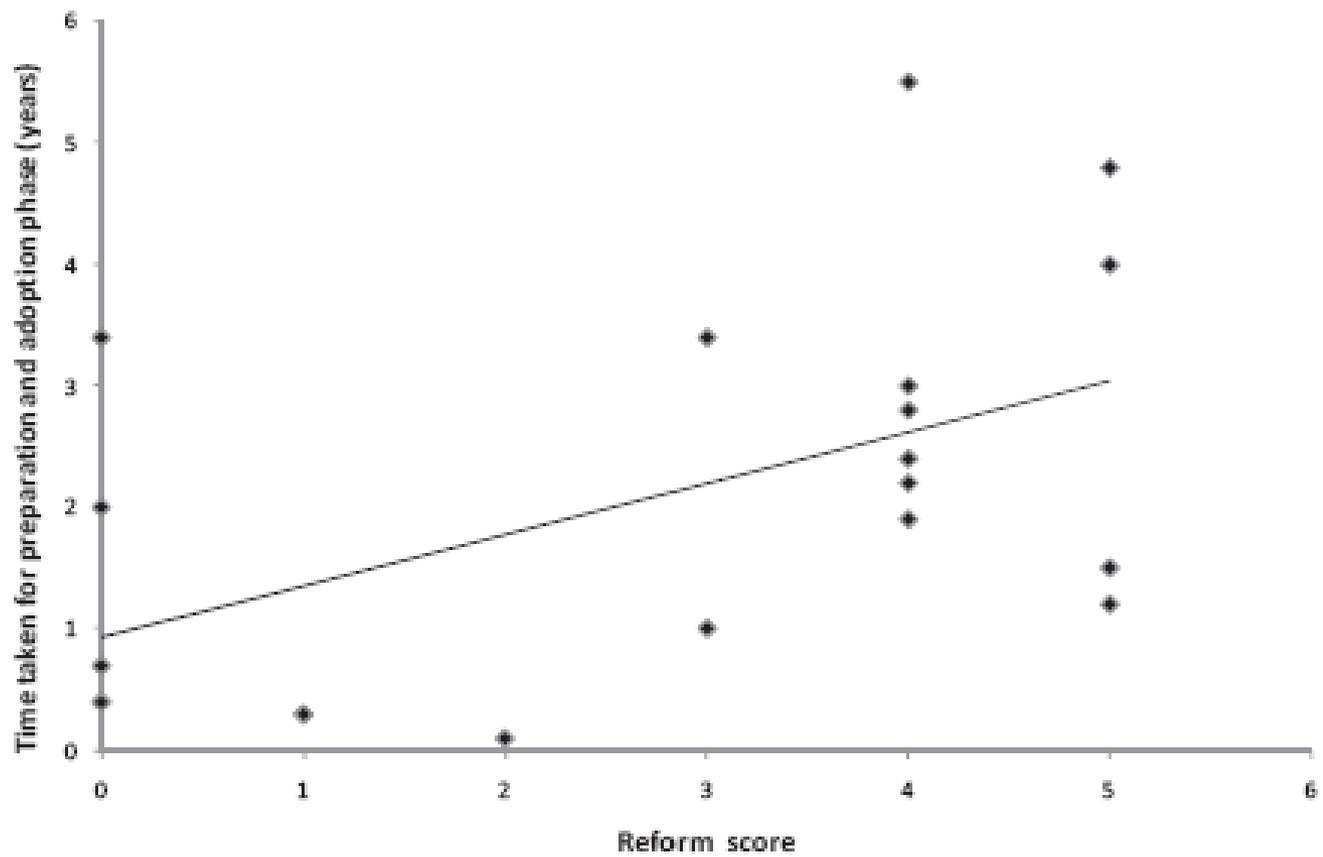
- The *business cycle* does not appear to matter very much for pension reforms.
- In other domains, the cycle does not appear to affect prospects for reform adoption much, but the process tends to be smoother when reforms are adopted at the bottom of the cycle and implemented during a recovery.
- While *high* unemployment can create pressure for labour-market reform, *rising* unemployment makes it likely that any reforms will focus on labour-market “outsiders”.
- *Fiscal stress* can generate pressure for reform, but a weak fiscal position can make reform adoption more difficult, and a focus on immediate savings can pose problems.

# Timing, scope and sequencing

- Events may open “*windows of opportunity*”, either by forcing action or easing constraints.
- Whether “bundled” or not, individual reforms tend to be easier to advance against the backdrop of a *broad on-going reform process*.
- *External pressures* are important reform drivers, particularly in the case of product-market reforms.
- *More haste can make for less speed*: complex reforms take time to design and adopt, as well as to bear fruit.
- *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 but they may also intensify resistance from those exempted from the first wave of reform. A strategy for ensuring continued reform is desirable.

# The link between preparation time and outcome is asymmetric but striking

Figure 2.3. Reform scores and speed of reform



# Communication, consultation & leadership

- Effective *communication and consultation* are 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. This is often an obstacle to product-market reforms, in particular.
- Specialised “*reform institutions*” can help foster this understanding.
- *Concertation* is no substitute for government leadership.
- “*Ownership*” of reforms is important: reform “orphans” are rarely successful.

# Dealing with winners and losers

- *Involving potential opponents* may facilitate adoption of reforms – but at a price.
- “*Acquired rights*” cannot easily be violated. Often this requires exempting some groups from the reform, but this is not always feasible.
- *Tactical concessions* to potential losers can often be coherent with the reform, rather than tending to compromise it.
- *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.

# Some implications for reform design

A few preliminary thoughts on the relationship between political economy and policy design:

- Reform design and strategies for adoption must take into account the *interests of those who will implement* the reform.
- *Good research* is no “fix” for politics, but it helps. The quality of the analysis underlying a reform can affect prospects for both adoption and implementation.
- Creating “*early winners*” or *new actors and institutions* early in the course of a reform can help to sustain the momentum behind it.
- Where elements of a reform are to be implemented with a delay, it helps to render them as “*automatic*” as possible.
- Reform often requires “learning by doing”, so mechanisms for *feedback and adjustment* can be critical.

# Two obvious – but important – points

1. *“If at first you don’t succeed...”*

Major structural reforms are rarely successful at the first attempt: the more successful reforms in the study generally followed earlier setbacks and many of the less successful cases set the stage for subsequent reforms.

2. Reforms *do not have to be perfect to be successful*. This is particularly true where reforms are “at the frontier” and reformers must “learn by doing”.