

THE ROLE OF ESTIMATING THE RISKS
IN THE COSTING OF STRUCTURAL REFORMS
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Structural Reforms and ERP Preparation in SEE

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This learning initiative is delivered as part of the EU funded multi-country program aimed at strengthening line ministries' capacities to assess fiscal implications of structural reforms.



Outline

- What are structural reforms?
- Costs, (financial) risks and prioritization of reforms
- Why are reforms so difficult?
- What are the reforms in 2019 ERPs?
- Exercise: analysis of selected ERPs

Examples of structural reforms

Energy efficiency

Liberalization of g/s markets

Investment in industrial sector

Fiscal cadaster of buildings

Law on public private partnsh.

Review administrative charges

Development of SME

Research and development

Judicial institutions

Liberalization of labour

Link health s. with treaursy

Vocational education

Why do you consider these measures to be structural reforms?

- Change of systems or institution
- Job creation
- Reduction of public debt/expenditure
- Removing obstacle to growth
- Increasing competitiveness/growth
- Increasing investment

Official definition of structural reforms for (potential) candidate countries

The term *structural reform* shall be understood to mean public policies that ***tackle obstacles to the fundamental drivers of growth***, that ***facilitate the use of resources and productive factors as efficiently as possible*** or that ***contribute to a more equitable and inclusive economy***. (ERP Guidance 2019)

- *Do our examples match this definition?*
- *Are there any potential conflicts between objectives of structural reforms?*
- *Can investments in infrastructure be considered to be structural reforms?*

This includes policies that ***modernise labour markets*** and make them more ***adaptable and responsive***, make product and service ***markets more efficient***, simplify the ***regulatory environment*** for businesses while increasing ***transparency*** overall in the economy, as well as policies that create ***equal opportunities*** and ensure ***social inclusion***. More efficient, innovative and transparent markets will benefit all market players and should encourage decent job creation and investment and improve productivity. Public investments in ***infrastructure*** can be included as measures if they contribute to reforming a market.

Definition of structural reforms for the member states

Structural reforms ***tackle obstacles to the fundamental drivers of growth*** by ***liberalising*** labour, product and service ***markets***, thereby encouraging job creation and investment and improving productivity. They are designed to boost an economy's competitiveness, growth potential and adjustment capacity.

https://ec.europa.eu/info/business-economy-euro/growth-and-investment/structural-reforms/structural-reforms-economic-growth_en

Typical structural reforms include policies that ***make labour markets more adaptable and responsive, liberalise*** service sectors, ***boost competition*** in product and service markets, specific sectors, or improve the overall ***business environment***, encourage ***innovation***, improve the quality of public ***taxation systems***, address the challenges of ***population ageing*** on the welfare state.

- *How are these two definitions different?*
- *Why do you think they are different?*
- *Are the differences justified, in your opinion?*

Structural reforms in economic theory

- Two objectives of economic policy
 - (macroeconomic) stability [AGGREGATE DEMAND]
 - (microeconomic) efficiency [SUPPLY SIDE]
- Structural reforms increase efficiency / productivity by ***changing incentives and constraints*** under which economic agents operate
 - Competitive markets, flexible labour markets, privatization, deregulation, efficient governments and public sector, adjusting subsidies and transfers

Structural reforms in economic theory

(Egert, Gal: Quantification of structural reforms in OECD countries, OECD working paper 2016)

Structural policy areas	Size of a typically observed	Total effect on GDP per capita	Impact on supply side components		
			MFP	K / Y	L / N
		<i>in percent</i>	<i>in percent</i>		<i>in percentage points</i>
Product market regulation		0.72%			
ETCR (0-6, 6 is strictest)	-0.31	0.72%	0.53%	0.07%	0.10
Intermediate policy channels mainly affecting		0.87%			
Openness	4.01	0.79%	0.79%		
R&D (business exp.)	0.10	0.09%	0.09%		
Investment specific policies		0.28%			
Corporate tax	-0.98	0.28%		0.57%	
Labour market policies		2.88%			
Labour market regulations		0.22%			
EPL (regular contr., 0-6, 6 is strictest)	-0.30	0.22%		0.24%	0.07
Tax-benefit and activation policies		1.39%			
Unemployment benefits	-1.42	0.31%			0.21
ALMP spending	3.18	0.46%	0.09%		0.25
Tax wedge	-2.28	0.36%			0.24
Tax wedge (single)	-1.39	0.25%			0.17
Wage setting institutions		0.58%			
Excess coverage	-1.89	0.09%			0.06
Minimum wage	-2.48	0.49%			0.32
Labour market policies for		0.69%			
Family benefits in kind	0.11	0.17%			0.11
Maternity leave weeks	4.83	0.42%			0.28
Legal retirement age	0.57	0.10%			0.06

How are the EC definitions different from the economic theory?

A possible reconciliation: an institutionalist's view of structural reforms

Types of Market-Supporting Institutions

- Property Rights
- Regulatory Institutions
 - Anti-trust regulation, financial supervision, securities regulation
 - Examples: FDIC, FCC
- Institutions for Macroeconomic Stabilization
 - Stabilizing function
 - Example: Central Bank
- Institutions for Social Insurance
 - Provide insurance against risks associated with dynamic markets
 - Concept of Welfare State
 - Examples: Social Security, Unemployment Compensation
- Institutions for Conflict Management
 - Facilitate Coordination Failures (cleavages)
 - Examples: rule of law, judiciary, free elections, representation of minorities
- Participatory Politics (meta institution)
 - “elicit and aggregate local information and thereby help build better institutions” (Rodrik 2000, p. 14)

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Based on
Dani Rodrik:
Institutions
for high
quality
growth,
NBER 2000

What have we learned so far?

- Structural reforms became popular with the emphasis on flexibility and competitiveness of economies (as opposed to macro-management of economic cycles)
- The EU's Lisbon Strategy (2000) tried to combine the drive for competitiveness with the modernization of the „European Social Model“
- The ERPs combine competitiveness with the need to strengthen employment and welfare
- The institutionalist view of „market supporting institutions“ may be very close to the development needs of SEE economies

Costs, risks and prioritization of reforms

- Now go back to our list of structural reform examples and do some mental exercise:
 - Select 3 reforms that you think would be the **most costly** to implement
 - Select 3 reforms that in your opinion carry the **highest financial risk**
 - Finally, select 3 reforms that you think are **the most important** ones to be implemented
- How different are your selections of costly, financially risky, and important reforms, and why?

Examples of structural reforms - the most **costly** ones?

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Investment in industrial sector

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Link health s. with treasury

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Examples of structural reforms - the most **financially risky** ones?

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Examples of structural reforms

- the most **important** ones?

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What criteria have you used to decide which are the most important reforms?

- Effect on growth
- Effect on pollution, welfare, health
- Exports
- Public debt, expenditure
- Linked with everything else
- Requirement from EU

Let's compare this with the OECD Prioritization Tool for ERPs!

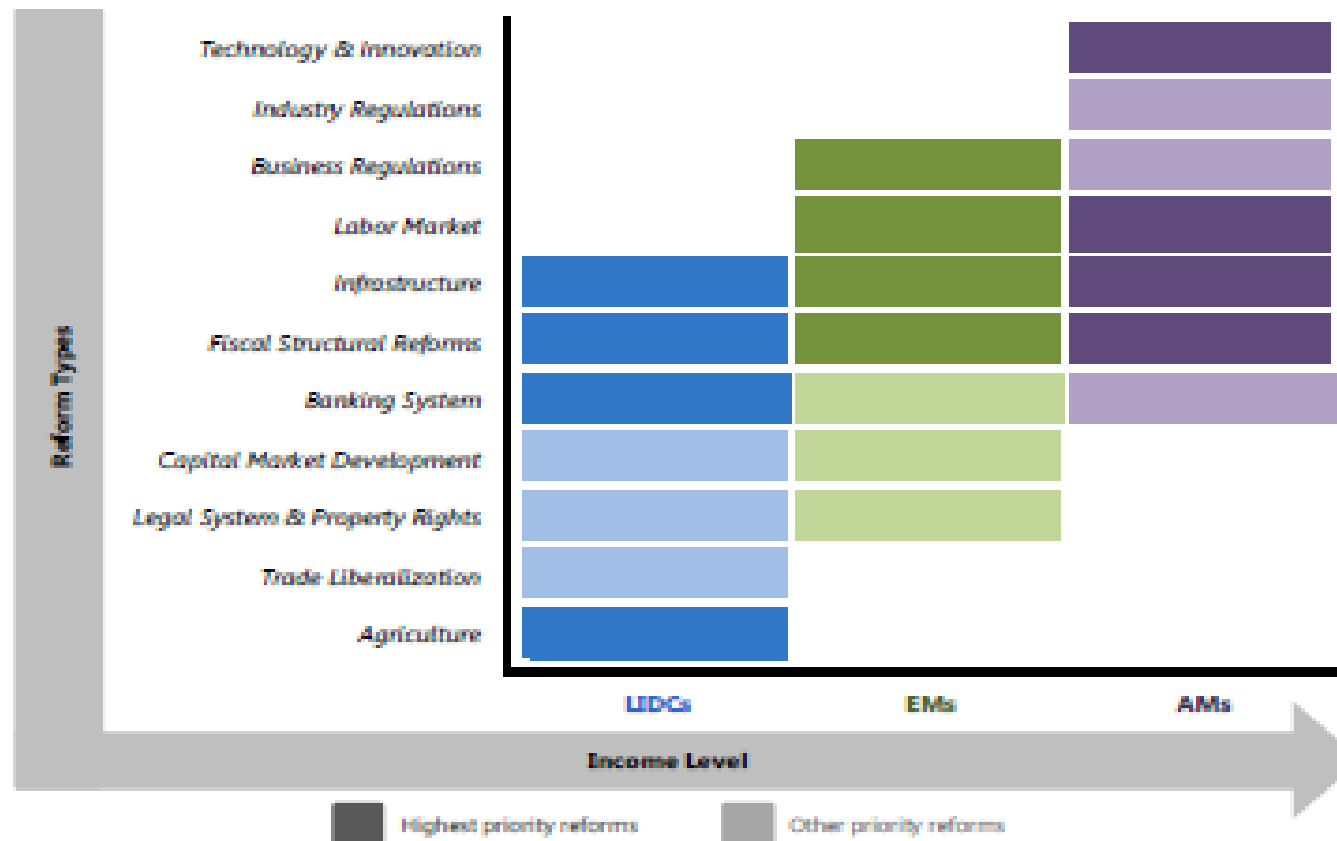
Prioritization of reforms – OECD's ERP Tool

- Screening (cut-off) questions:
 - Addressing a binding constraint to growth?
 - Sufficient capacity and funding for implementation?
 - Clearly defined activities for implementation?
- Selection questions:
 - Impact on competitiveness / growth
 - Impact on employment
 - Implementation complexity
 - Implementation risks
 - EC assessment of the measure (if rolled-over)

Should financial risks be one of the criteria for prioritization or reforms?

Another look at prioritization

Figure 16. Structural Reforms with Highest Productivity Payoffs within Each Country Group



Note: Comparisons among reforms, within each country group. Darker shades represent the higher priority reforms likely, on average, to have larger gains.

Source: IMF staff estimates.

IMF 2015:
Structural
reforms and
macro-
economic
performance

Why are reforms so difficult?

Your reasons

Typical reasons in the political economy of reforms

- Uneven distribution of costs and benefits among social groups
- Uncertainty about costs and benefits
- Influence of vested interests (status-quo interest groups)
- Unpopularity of reforms and re-election concerns
- Imperfect decision-making and coordination ability

Let's consider some „solutions“ from the literature

- Compensations to „losers“ and stimulation of the overall economic growth
- Optimal timing – before or after elections? In good or bad economic times? Reforms with quick results first?
- External pressure (international institutions, financial instability, globalization)
- Full and open information on options and expected results

Implementation of ERP structural reforms

No implementation (0)	1 %
In preparation (1)	4 %
Initial implementation (2)	17 %
On-going (3)	22 %
Advanced (4)	44 %
Completed (5)	12 %

Based on self-assessment of implementation in 6 ERPs 2019-21 (except Turkey), Table 11.

Implementation of country-specific policy recommendations	
Limited	2 countries
Partial	5 countries

Based on European Commission assessment of 7 ERPs 2018-20 from March 2018.

Structural reforms in 2019 ERPs

ERP policy sector	Number	Share	Most frequent reforms
<i>Energy and transport markets</i>	18	16 %	Market liberalization/opening Energy efficiency, renewable sources Infrastructure
<i>Sectoral development</i>	15	14 %	Agricultural investment, production Industrial policy Tourism
<i>Business environment</i>	32	29 %	Reduction of regulatory burden, e-services Informal economy, tax collection, inspections Support to SMEs
<i>RDI and digital economy</i>	12	11 %	RDI system and support Broadband infrastructure/regulation
<i>Trade-related reforms</i>	7	6 %	Trade facilitation
<i>Education and skills</i>	13	12 %	Aligning VET with labour market needs
<i>Employment and labour markets</i>	6	5 %	Active labour-market policy measures
<i>Social inclusion</i>	9	8 %	Social protection system Health system

Based on 6 ERPs 2019-21 (except Turkey), Chapter 4.2. Summary of reform measures.

Exercise: analysis of selected ERPs

(Serbia, N Macedonia, Kosovo*)

- 1) On the list of structural reforms (chapter 4.2), select the ones that in your opinion are the most important, the costliest, and financially the most risky ones
- 2) Look at the costing table (10a) and costing summary (ch. 5) and compare it with your assumptions about the costs
- 3) Look at the explanations of risks with each measure (ch. 4.3) and compare it with your assumptions about financial riskiness
- 4) Check the fiscal priorities and expenditure outlook (ch. 3.1 and 3.3.) and compare it with prioritization of reforms