Center of Excellence in Finance

Understanding and conducting the structural reforms' beyond fiscal implications assessments

Qualitative aspect

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Why do we need implication assessment of structural reforms (SRs)?

- It shows us if we are on the right track, i.e. if defined goal can be achieved by SR implementation.
- Implication of a SR helps us to assess related SRs' implications.
- Implementation of SR needs to be argued by its implication.
- It addresses relevant stakeholders.

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The structure of presentation follows the answers to questions:

1. What are SRs?
2. What are measures of structural reforms?
3. How to classify SR?
4. When do we need the SRs?
5. Who proposes SRs?
6. How the goal is a benchmark for impact assessment of SR?
7. Can we „copy“ the implication of already implemented structural reforms?
8. How much timeline is important for SRs' implication assessment?
9. How interdependence affect implication assessment of SRs?
10. How much political environment is important for the the context of assessing SRs implications?
11. Don't forget expectations!

1. What are SRs?

- There is no single and generally accepted definition of SR
- ERP Guidance (2019): SRs are public policies that:
  - tackle obstacles to fundamental drivers of growth,
  - facilitate the use of resources and productive factors as efficiently as possible
  - contribute to a more equitable and inclusive economy.
- Structural reforms promote competitiveness and long-term sustainable growth by changing incentives and constraints addressed to:
  - Strengthen employment and welfare;
  - Enhance productivity;
  - Increase the efficiency of resources allocation;

2. What are measures of structural reforms?

- Structural reforms are implemented through policy measures.
- Measures of certain structural reform are concrete policy efforts that make:
  - regulatory changes
  - institutional changes,
  - financing, and/or
  - sometimes, public investments in infrastructure
- The individual goals of the SR's measures converge to SR's goal.
- Each measure has to produce better functioning of <u>supply</u> (e.g., lower prices due to market opening), but also <u>demand</u> (e.g., education reforms make changes in peoples' needs) side of the economy.

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2. What measures are not part of structural reforms?

- All public investments in infrastructure are not at the same time measures of SR, but only those that support reforming a market.
- For example, building a kindergarten for higher coverage of kids with pre-school education is SR measure. But, building kindergartens in order to optimize the number of kids in kindergartens because of increase of inhabitants in that city quarter- is not. Structural reforms are not private investments. Private investments are results of SR.
- FDIs are not SRs, although they open the market. For example, government makes valorization of touristic resorts by facilitization of bussiness environment in order to attract FDIs in tourism industry. In this case, SR is a set of measures necessary for new investment climate (e.g. lowering tax rates, shorter period for getting permistions, long period of public land lease, etc.). Expected FDIs are assessed impact of that SR.

3. How to classify SRs?

- Structural reforms are classified referring to certain fields of economy where obstacles to growth exist, enhancing government effectiveness, regulatory quality, human capital and financial development.
- The broader classification implies two packages: labor market and product market SRs.
- Western Balkan countries and Turkey implement classification according to ERP Guidance (2019):

Product market reforms:

- Energy and transport market reform;
- Agriculture, industry and services;
- Business environment and reduction of the informal economy;
- Research, development and innovation and the digital transformation;
- Economic integration reforms;

Labor market reforms

- Education and skills;
- Employment and labor market;
- Social protection and inclusion.

Notification: this classisification is a subject of change according to annual ERP Guidance

4. When do we need the SRs?

- Usually, ideas and discussion about SRs comes up during the crisis.
- Crises arise due to problems as structural bottlenecks that act as drag on growth. Problems need solutions and solutions are changes of the system.
- SRs are a call for higher resilience of the country
- Rarely, structural reforms are implemented when things go well, but there is still room for improvement (potential output).

5. Who proposes SR?

- Ideally – every participant of the economic system able to identify obstacles to growth
- Realistically - Ministry of finance (MF) and line ministries (LM).
- Ministers usually have ideas having holistic approach and/or political motivation
- **Experts, analysts in MF and LM are those who measure the implications of SRs.**
- **The implication assessment must be the baseline of consideration- should certain SR or package of SRs be implemented or not.**
- Therefore, the implications are the main tool for negotiating about implementation of SRs. Thus, your role in this process is highly important
- Broader social discussion can help you to "feel" the non-measurable inputs for assessments

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6. How the goal is a benchmark for impact assessment of SR?

- The goal, set for certain SR, is a benchmark for its impact assessment.
- For example, if pension reform aims to increase pension fund by decreasing informal employment and increasing pension contribution revenues by 20%, then impact assessment of all implemented measures has to converge to that goal.
- Sometimes, impact assessment helps us to confirm if the measures are adequatly designed and if their goals converge to overall SR's goal. For example, government aims to attract investments by decreasing corporate tax. Impact assessment and analyses of bussiness environment show that corporate tax is not a barrier to FDIs, but para-fiscal taxes are. Although the goal is set correctly, impact assessment forces redesign of SR's measures in direction to its goal.
- SRs' mechanisms such as privatization, liberalization and deregulation have aim to eliminate obstacles to functioning labor, goods and services markets with goal to:
  - Make it easier for firms to fire unwanted employees,
  - Break business and union monopolies,
  - Privatize state asset,
  - Reduce regulation and red tape,
  - Remove parafiscal costs
  - Improve efficiency of the courts
  - Enforce property rights
  - Enhance contract enforcement,
  - Achieve fiscal sustainability,
  - Implement green technologies,
  - Promote inclusive growth, and so on.

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7. Can we „copy“ the implication of already implemented structural reforms? (1)

- Avoid implementation of “best practices”. Learn from them, not copy them.
- Rely on your own impact assessment- for example, the same measure can produce opposite effects in different countries, even in different periods of time in your country.
- For example, cutting the red tape and reducing regulation does little to spur private economic activity when constraint lies on the financial side. Improving financial intermediation does not raise private investments when entrepreneurs expect low profits.
- Identification of obstacles helps designers of SR to assess their implication.
- If an obstacle is identified and structural reform’s measures addressed to its removal then short-term negative effects are shorter or insensible.

7. Can we „copy“ the implication of already implemented structural reforms? (2)

Examples from the product market reform

Area	Sub-sector	Obstacle	Measure	Goal/Impact
Energy	electricity	High tariffs as result of inadequate investments in transmission infrastructure	Promoting investment in transmission network; increasing information transparency	Lower prices Lower inflation Higher investments
Public service	Local government	Non-competitive contract-award in favor of public servants; „in house“ contracting, Conflict of interest	Competitive tendering; strengthening enforcement and sanctions for non-compliance; monitoring by central government	Higher investments; business entering;

7. Can we „copy“ the implication of already implemented structural reforms? (3)

Examples from the labor market reform

Area	Sub-sector	Obstacle	Measure	Goal/Impact
Contracts and labor market entry	Temporary contracts	Disincentives for investing in skills and human capital; subject to abuse	Tax disincentives for fixed-term contracts, sanctions for abuse of atypical contracts	Lower labor costs; higher employment
Youth employment	Very low participation	Labor market cannot generate the increasing number of young workforce supply	Tax incentives to hire youth; establishing a special type of company for young entrepreneurs; apprenticeship contracts	Higher employment; fiscal sustainability

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8. How much timeline is important for SRs' implication assessment ?

- SRs take time to implement and time to perform the effects.
- Implications of SRs usually take mid-term to materialize.
- Many studies show positive impact of SR in the long-run.
- Long-term implications could be easily assessed in the form of overall reform goals.
- Product market reforms are those more likely to have the greatest positive impact over short to medium-term, especially in the tradable sector.
- Some of reforms have shorter period of time to achieve positive effect: tax reforms (cutting tax burden on labor), financial sectors reforms (lifting credit constraints).
- Changes in governance such as organizational routine, creation of new institutions take longer time to reach positive effects even if initiated quickly.

8. Why short-term implications of SRs are so important? (2)

- Short-term implications are those that attract attention because:
  - of the relevance for political economy
  - of design of individual measures.
- Sometimes short-term impact differs from long-run effects. For example:
  - pension reform makes pressure on public finances in short run due to transition cost, but in long run it contributes to fiscal stability
  - innovations take time and costs to produce effects and may depress short-term aggregate supply, but in long run it increases productivity.
  - investments in education also entails short-term costs, but benefits appear in long-run.
  - privatization makes unemployment higher in the short run, but increases sustainability of firms and possibility for new employments in the long run.
- OECD and IMF's research show that some structural reforms may have even short-term recessionary effects.

8. What makes some countries to have recessionary short-term effects of SRs and others more accelerative to growth? (3)

Or, what is important to be taken in account before assessing short term implications of SRs?

- **Government's attitude**. Governments more shifted to rhetoric do not put emphasis on actions, delaying implementation or not doing it at all. That makes short term positive implications weaker. Contrary, proactive governments are supportive and focused on lowering negative effects.
- **Growth friendly environment**. Supportive economic policy and society amplifies the medium-term benefit of labor and product market.
- **Institutional conditions**. More restrictive regulation is a burden to SRs' implementation and brings higher costs and negative effects.
- **Macroeconomic conditions**. If the reform is implemented during recession its performance could be negative, especially labor market reforms.

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8. What makes some countries to have recessionary effects of SRs and others more accelerative to growth? (4)

- **Technological gap**. Countries closer to the technological frontier have higher increases of productivity, while those lagging behind may have negative short-term effects of SR.
- **The sources of financing** could also make different implications during the time. The short term and long-term fiscal impact of the measures are different depending on whether financing is from external sources or from reduction of costs.
- **Stage of EU accession** for small countries may result in large upfront costs of SRs.
- **Answer to COVID-19** determines initialization of new or effects of implemented reforms. If the country experienced significant GDP contraction in 2020, it will have to invest in SRs package to increase resilience. Or if it spent significant resources for covid-measures, it will have to give up from expensive current SR and design more appropriate ones.

9. How interdependences affect implications of SRs?

- Simultaneous market structural reforms are typically more growth enhancing then isolated reforms
- By its nature, SR makes systemic changes with direct implication on targeted segment of economy and indirect on others
- Interdependence of SRs is a road to its better performance, as well as to accurate and coordinated implication assessment
- Better and faster performance comes from articulated and coherent packages of SR
- Coordinated reforms maximize synergy across areas and improve accuracy of implication assessment
- For example, Greece implemented adjustments from the side of workers, doing a little on side of monopoly powers and barriers
- Design and assessment of articulated SRs is interdisciplinary work of MF and line ministries
- Spillover effect can be positive and negative in the short run.

10. How much political environment is important for the the context of assessing SRs implications?

- The influence of current political environment has to be taken in account through electoral cycle.
- Politicians are more sensitive to short term costs in proximity of elections.
- Newly elected governments might be most inclined to implement reforms.
- Reforms are more easily implementable if one party has the necessary majority in parliament.

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11. Don’t forget expectations

- Reforms may boost confidence and increase expectations of increased income, and according to theory, increase of consumption and investments in the short run.
- The effect in the short run could be negative – change produces uncertainty over future, and precautionary savings, decreasing consumption and investments.
- Organize meetings with bussiness and bank assotiations and labor unions, consultants, investors. Listen to them!