French Economic Association meetings
The political economy of reforms in Europe and France

A comparative view on reform complementarities

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This presentation summarises classes at Sciences-Po on reform strategies, which emphasize the importance of policy complementarity for a sustainable reform process.

Reports by Amable and Saint-Paul in previous sessions have not stressed this point enough, but the debate about “French gradualism” cannot be understood without a reference to reform design.

If reforms are conceived to be implemented by stealth, they are more likely to be piece meal and therefore not produce enough gains in terms of economic growth to be sustained. In other words it will be all pain no gain!
Instead, if the coherence of reform strategies can be measured and comparisons across countries can be made, then best international practices might be emulated and seemingly unsurmountable economic (let alone cultural) differences overcome. This is especially true when multilateral surveillance recognizes long term objectives (EU membership) as credible terminal conditions, or when cries occur. Two examples, from transition countries and emerging markets respectively, are available from earlier work: Braga de Macedo and Oliveira Martins (2006), Growth, Reform Indicators and Policy Complementarities, *NBER Working Paper* no. 12544, September.

Using a larger sample, which draws on EBRD and World Bank Doing Business indicators, a paper being written asks suggests that complementary reforms are not a "luxury" in developing countries.

Braga de Macedo, Oliveira Martins and Rocha (MMR), *Are complementary reforms a "luxury" in developing countries?*

MMR define certain policy complementarities that are more important than others at certain stages of economic development to see how complementarity affects the catching-up process, and thus make a link with sequencing.

Another idea is to deal with policy priorities (cf. Hausman & Rodrik's paper on growth diagnostics) through the weighting scheme of the reform indicators
### Ex: matrix of policy complementarities

<table>
<thead>
<tr>
<th>Health</th>
<th>Social security</th>
<th>Education and R&amp;D</th>
<th>Fiscal policy</th>
<th>Monetary Policy</th>
<th>Financial sector reform</th>
<th>Product markets</th>
<th>Labour markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health</td>
<td>--</td>
<td>Reduce early retirement by disability</td>
<td>Incentives for Human K accumulation</td>
<td>Reduce spending pressures</td>
<td>--</td>
<td>--</td>
<td>Better health status</td>
</tr>
<tr>
<td>Social security</td>
<td>Sustainable retirement incomes</td>
<td>--</td>
<td>Incentives for Human K accumulation</td>
<td>Reduce implicit liabilities</td>
<td>New market segments</td>
<td>--</td>
<td>Reduce labor tax wedges</td>
</tr>
<tr>
<td>Education and R&amp;D</td>
<td>Healthy lifestyles; Innovation</td>
<td>Financial literacy</td>
<td>--</td>
<td>More effective spending</td>
<td>Non-price competitiveness</td>
<td>Financial literacy</td>
<td>Higher skills</td>
</tr>
<tr>
<td>Fiscal policy</td>
<td>Resources for long-term financing</td>
<td>Resources for long-term financing</td>
<td>Resources for long-term financing</td>
<td>--</td>
<td>Aggregate demand management</td>
<td>Avoid Crowding-out</td>
<td>Reduce producer tax wedges</td>
</tr>
<tr>
<td>Monetary Policy</td>
<td></td>
<td>Improved individual financing</td>
<td></td>
<td></td>
<td></td>
<td>Reduced inflationary pressures</td>
<td></td>
</tr>
<tr>
<td>Financial sector reform</td>
<td>Higher activity rates, Innovation</td>
<td>Development of annuities, reverse mortgages</td>
<td>Improved individual financing</td>
<td>Prevents systemic risks</td>
<td>Prevents systemic risks</td>
<td>--</td>
<td>Improved credit conditions</td>
</tr>
<tr>
<td>Product markets</td>
<td>Higher activity rates; Innovation</td>
<td>More employment for older workers</td>
<td>Increases return on education</td>
<td>Improves profitability and tax base</td>
<td>Lower price pressures</td>
<td>Lower level of bad debts</td>
<td>--</td>
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<tr>
<td>Labour markets</td>
<td>Higher activity rates</td>
<td>More employment for older workers</td>
<td>Increases return on education</td>
<td>Improves employment and tax base</td>
<td>Lower wage pressures</td>
<td>Lower risks of excess indebtedness</td>
<td>Easier Entry/Exit mechanisms</td>
</tr>
</tbody>
</table>

→ Positive spillover of policy (row i) on policy (column j)
Some examples in the EU (1/2)

- **International competitiveness and human capital policies**: the EU Lisbon strategy focuses on becoming the most competitive economy in 2010 mentions policy coherence and provides many structural indicators to be monitored, but the complementarity between real exchange rate, relative prices and human capital policies needs more attention.

- When real exchange rate adjustment is constrained by EMU, relative prices between tradable and non-tradable goods & services may hinder the development of the

- Moreover, strong upward price pressures in the non-tradable sector (e.g. Services) require an appropriate framework for competition policy and regulatory reform.
Some examples in the EU(2/2)

• Pension reform and labour market performance: many OECD countries, inc. France, increase the retirement age but this will not produce results if the labour market is not creating jobs for older workers.

• Taking this complementarity into account will increase the benefits to both reforms, making them more visible to public opinion and broadening the political support they need in order to be fully carried out.

• Tertiary education reform with introduction of tuition fees and individual financing systems. Higher cost of education may decrease private incentives to invest in human-K when students are liquidity constrained.
GDP growth and average reform level

New EU members

GDP growth

Period where Complementarity increased

Period where Complementarity decreased

➔ Importance of the terminal conditions