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 unsourmountable 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.

Rocha (2007), At Different Speeds: Recovering from the Asian Crisis , *ABD Institute Working Paper* nº 90, February.

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

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

➔ 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 focus 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.

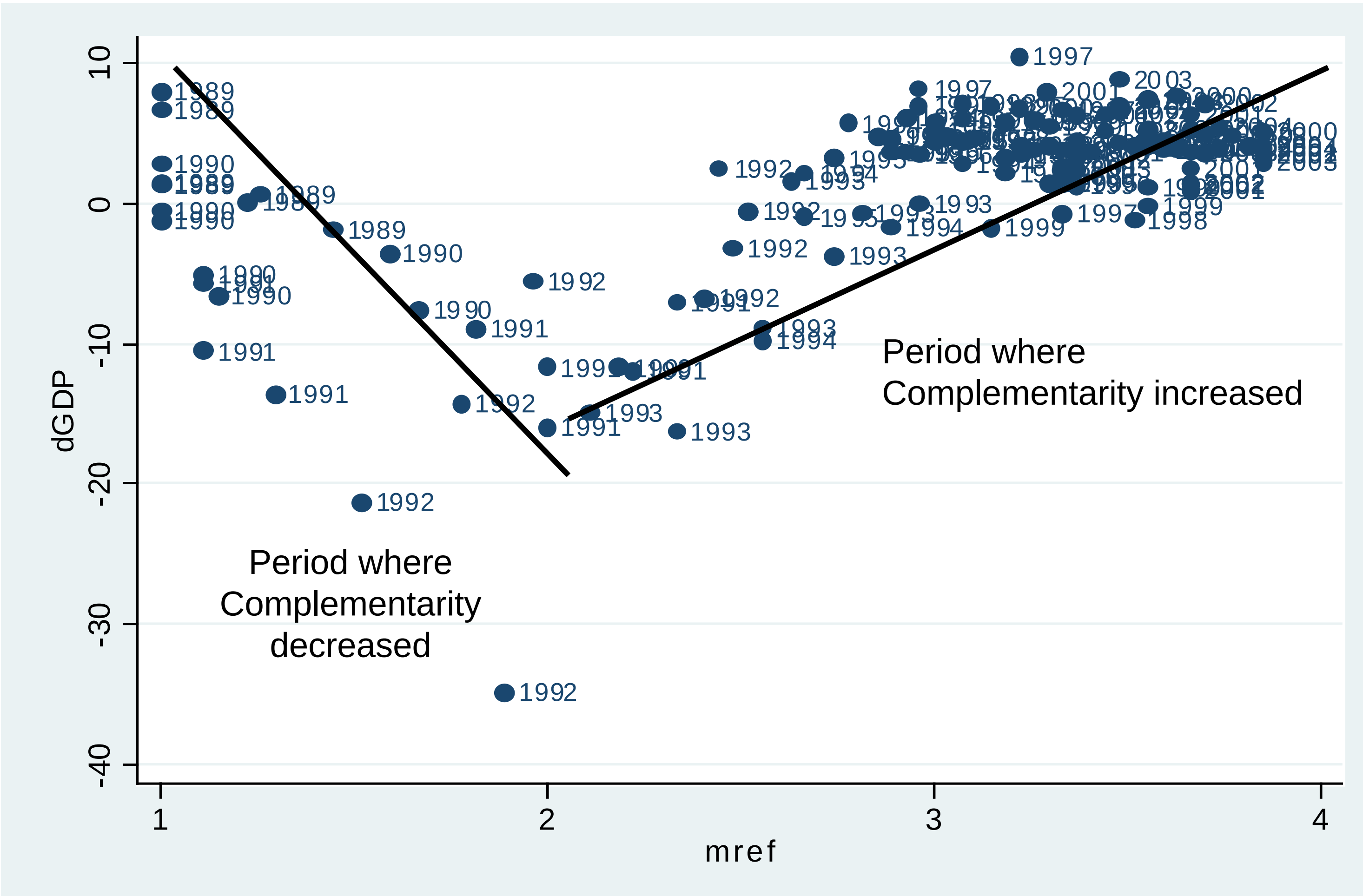
Some examples in the EU(2/2)

- **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



Reform level (RL)

➔ Importance of the terminal conditions