

## *Research Fellowship Programme – Growth perspectives for the EU*

### **Essay on "The political economy of fiscal consolidation and structural reforms revisited"**

#### **Background:**

It is often argued that a crisis offers a window of opportunity for reforms as it makes the deficiencies of the status quo apparent. The public at large may become increasingly aware of the general need for reform as it is exposed to the hardship aggravated by the malfunctioning of the existing institutions. Alternatively, the crisis may erode the rents arising to specific interest groups which could reduce their opposition to reform. This general "crisis effect" may intensify the perceptions of the necessity to push forward with reforms.

However, fiscal consolidation and structural reforms often inflict more or less wide-spread short-run pains in terms of employment and income losses, while the benefits tend to materialise only over the medium- to long-term. In addition, some structural reforms are difficult to implement in a period of strict fiscal consolidation. Also, the perception of fair burden- and benefit-sharing across society is essential in order not to undermine social and political acceptance of reforms. Consequently, reform-minded governments face important political constraints.

#### **Aims of the essay and key questions:**

The objective of the essay would be to revisit the existing finding on the political economy of implementation of fiscal consolidation and structural reforms in view of the experiences from the recent financial and economic crisis, which in its magnitude and economic implications exceeds all post-war recessions.

Important issues to be addressed include:

- While there is an urgent need to implement a number of growth-enhancing structural reforms, part of them are difficult to implement in the context of fiscal consolidation. However, their postponement would be detrimental to economic growth and could make the fiscal consolidation measures even more difficult to implement due to lack of political support. The analysis could address the issue how to undertake the necessary structural reforms in the context of fiscal consolidation.
- Learning from post-crisis experience, the envisaged analysis could re-assess how best to address potential trade-offs between growth and equity considerations in the design and sequencing of fiscal consolidation and structural reforms. It could also explore under which conditions the short-term negative impact of consolidation and structural reforms can be optimally spread across the population.

- Particular emphasis could be given to the efficiency of public spending in relation to its distributional impacts, and the mix between revenue measures, public investment and primary current spending. Another focus should be put on tax reforms, in particular the ways to achieve fair and growth-friendly changes in the structure of taxation and possible trade-offs involved, taking into account the fiscal consolidation constraints currently faced by many EU member states.
- As public finances will likely remain constrained in the future, the envisaged analysis could also consider the issue of availability of public goods such as education, healthcare or social assistance. In particular, it could consider the possible modes of provision and financing of such goods.
- The analysis could examine the role and efficiency of external constraints in fostering fiscal consolidations and implementation of structural reforms, such as conditionality attached to IMF/EU programmes, market pressures or arrangements for coordination of economic policies, including the new elements in the EU governance framework such as the Macroeconomic Imbalance Procedure and the reinforced Stability and Growth Pact.