How to gain political support for reforms?

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Reforms: strategy matters

- Economic change $\Rightarrow$ economic reforms
- “When a law is voted by the Parliament [...], it must be applied”
  (President Chirac, March 24, 2006)
- “If you are to suffer, you should suffer in the interest of the country”
  (Nehru 1948)
- Benefit to national economy is not enough: reform strategy is crucial as well
Reforms: stylized facts

- Paper surveys several reform experiences (failures and successes)
- We identify 4 recurrent strategies

In all cases, two stages are instrumental:
- **Coalition building** (bring out supporters)
- **Commitment building** (create incentives to support reform)
Partial overview of case studies

<table>
<thead>
<tr>
<th>Economic Impact of Reform</th>
<th>Political Features</th>
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<tbody>
<tr>
<td>Broad</td>
<td>Strong government</td>
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<td></td>
<td>Pensions (UK, Italy, France)</td>
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<td>Weak government</td>
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<td>Pensions (Italy), Labour market (Denmark), Mass privatizations (Central Europe)</td>
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<tr>
<td>Narrow</td>
<td>Strong government</td>
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<td>Privatizations (UK)</td>
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<td>Telecom (Italy, France) Deregulations in non-manufacturing (OECD countries)</td>
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## Typology of reform strategies

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<tr>
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<tbody>
<tr>
<td></td>
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<tr>
<td>Broad</td>
<td>Median Voter</td>
<td>Median Voter</td>
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<td>Parl. Maj. &amp; some special interests</td>
<td>Widen political base for reform</td>
</tr>
<tr>
<td>Narrow</td>
<td>Special interests</td>
<td>Special interests</td>
</tr>
<tr>
<td></td>
<td>Divide and rule tactics</td>
<td>Divide and rule + exploit external constraints</td>
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Reforms: winners and losers

- Clichés
  - Pass or fail if economically “good” or “bad”
  - Attracting median voter is sufficient
    (= parliamentary majority is enough)

- Realities
  - Benefits not always transferable
  - Hidden transfers may be more easily tolerated
  - Veto players might not be the voters
    (lobbying)
Three main issues

1. Why and how do politicians commit their “capital” in favour of a reform?

2. What stands on their way? Where do oppositions come from?

3. Do oppositions matter? Can they be circumvented?

⇒ How to reform?
Main lessons

- Many reforms have been implemented
  - Although sometimes reversed later

- Some reforms fail under some strategy...
  ...but are successful under a ≠ strategy

- Variation: countries, sectors, and time
Past regulatory reforms

- Timing and scope varies across countries
Past regulatory reforms

... and across industries
Strategy 1: Exploit parliamentary majority

- Strong government may impose reform
  - Elected on a *pro-reform* platform
  - Impose reforms

- Constraints:
  - Parliamentary majority = political support (no veto player)
  - Incentive constraint: reelection (support along party lines)
Exploit parliamentary majority

- 1986: Thatcher pension reform
  - Retrenched public pension pillar (SERPS)
  -Introduced private pension funds

- Fully funded pensions + privatizations
  - Pension reform accompanied by privatisations
  - Created demand & supply for private funds

- Design: voters + special interests
  - Re-election motive: use voting models
  ⇒ target of pension reform was the middle class
“Extra ball”: momentum

- **Commitment**: “critical mass” effects
  - Coordinates expectations towards reforms
  - Shifts the debate & creates momentum

- **Transition countries**
  - **Some countries**: fast reforms built support
  - **Privatization + Liberalization**
  - **But**: *too much* “big bang”
  - **De jure ≠ de facto** (Russia)
Downside: reversals and failures

- **UK**: partial reversal in 1999 (Blair)

- Noteworthy failures:
  - 1994: Berlusconi’s pension reform
  - 1995: Juppé’s labour market reform
  - 2001: Rasmussen’s labour market reform
  - 2006: Villepin’s CPE?
Uncovering other strategies

- **Strategy 2: Widen political base**
  - Italy, after Berlusconi’s failure:
    - Shield losers from reform
  - Denmark, after Rasmussen’s failure:
    - Reform negotiated with unions; shift on flexibility
  - Transition: mass privatisations

- **Strategy 3: Divide and rule**

- **Strategy 4: Exploit external constraints**
Strategy 3: Divide and conquer

- *Buying* opposition may be too costly

- *Divide* strong entrenched interests
  - Reform: target particular sub-group
    (Not aimed at spreading benefits…
    …but at concentrating costs)
  - Example: non-manufacturing industries
    → complex web of special interests
Divide and conquer strategies

- Break vertical chain: intermediate goods
## Divide and conquer strategies

<table>
<thead>
<tr>
<th>Dependent variable</th>
<th>Regulation net of public ownership</th>
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</thead>
<tbody>
<tr>
<td><strong>Explanatory variables</strong></td>
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<tr>
<td>Regulation_{t-1}</td>
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<tr>
<td></td>
<td>7.14</td>
</tr>
<tr>
<td>EU membership</td>
<td>-0.03</td>
</tr>
<tr>
<td>Regulation_{t-1} * EU membership</td>
<td>-0.003</td>
</tr>
<tr>
<td>Public ownership</td>
<td></td>
</tr>
<tr>
<td>Regulation in trading partners</td>
<td></td>
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- **Corporatise first / Privatise later**
  - (Telecom Italia vs France Telecom)
“Divide” imposes *gradualism*

- Potentially: trickle down effects
  - Chain reaction effects within market
    (e.g. privatise to liberalise)…
  - …or across markets
    (e.g. product to labour)

- Sequencing: facilitate early reforms and reward next ones
  - Implement ‘easy’ reforms first
    (generate information, ‘hit’ targeted groups)
  - Downside: risk of waiting for crisis situations
Concrete cases

- **Telecom Italia vs. France Telecom**
  - Italy: separate corporation / reforms easier
  - France T: embedded in Telecom’s ministry
    Only risk of bankruptcy sparked reform

- **Electricity market**
  - EU: liberalized professional market first
  - Take advantage of tensions between buyers and sellers to tame oppositions
Strategy 4: Exploit external constraints

- **Failure to pass either coalition building or commitment building phase**

- **Fierce opposition**
  - Politically too costly to reform...
  - ...rely on external constraints (WTO, EC)
  
  ⇒ Reduces government’s accountability
Exploit external constraints

- **Downside**
  - Must bring sufficient economic payoff to provide justification ex post
  - Given internal oppositions: often used when government is cornered

- **Upside**: change identity of pressure groups
  - Changes “bargaining level”
  - Web of interests changes as well
Exploit external constraints

Privatisation of Škoda vs. AvtoZAZ

- **Political mood:** “fear” of foreign ownership

- Czech Republic (Škoda)
  - EU accession: “external anchor”
  - Used by government to build commitment for reforms
  - Outcome: success

- Ukraine (AvtoZAZ)
  - No such “commitment device”
  - Government fell prey to special interests
  - Outcome: failure
Ubiquitous Process

- The process has been identical for major natural monopolies, such as electricity

- Ukraine: same process of
  1. excessive protection
  2. verge of bankruptcy
  3. at last: efficiency-enhancing reforms

- External constraints created commitment and changed balance of power
  ⇒ constraints not always bad!
Summing up: “recipes” to reform

- Economic change $\Rightarrow$ economic reforms
- Displaying potential benefits: not enough
- Need to craft clever reform strategy
  - Exploit parliamentary majority is but one option
- Other possible strategies
  - Widen political base
  - Divide & conquer
  - Exploit external constraints
- Inform voters (reduce uncertainty)
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- Other possible strategies
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- Inform voters (reduce uncertainty)$\Rightarrow$ Potentially easier role for EC
More complete analysis:

STRUCTURAL REFORMS WITHOUT PREJUDICES

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