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The political economy of reform: emerging lessons from ten OECD countries

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Chapter 1

Introduction: Why past can be prologue

Introduction

The primary aim of this study is to identify political economy lessons that may be of use to policy makers seeking to design, adopt and implement structural reforms. Many of the political economy factors that facilitate or hinder economic reform have been examined in previous work by the OECD Economics Department[1] and numerous other institutions and researchers.[2] The present study seeks to build on this work, particularly previous work by the Economics Department, and also to contribute to the broader OECD project on "Making Reforms Happen", which focuses on the most effective ways to realise structural reforms across a wider range of policy domains than is considered here. In contrast to most previous political economy work by the OECD, this study adopts an inductive approach, based on case studies of attempts to adopt and implement structural reforms.[3] A relatively open approach, aimed at drawing general conclusions from the analysis of specific cases, would seem appropriate, given the lack of any well-established general model of the political economy of structural reform that could serve as the theoretical basis for a project covering such a wide range of reforms.

This study differs from most previous work on the political economy of reform in a number of respects. First, the academic literature on the political economy of policy reform, as well as much of that produced by international institutions, has tended until relatively recently to focus on developing countries and on instances of large-scale reorientation of economic policy, often in response to economic crises.[4] While the present study includes some episodes linked to crises, its focus is on structural reforms in developed countries, most often in conditions of "normal" rather than "extraordinary" politics.[5] Secondly, early research on the political economy of reform concentrated largely on macroeconomic and trade policy.[6] Until recently, there has been rather less work on the political economy of structural reform, particularly the reform of product markets.[7]

The study's principal messages may be summarised as follows. First, it pays to have an electoral mandate for reform. This is one of the strongest findings to emerge from the study. Reform "by stealth" has severe limits, and reform surprises tend to succeed only when reform generates visible benefits very rapidly, which major structural reforms generally do not. The importance of meaningful mandates makes effective communication all the more important: major reforms should be accompanied by consistent co-ordinated efforts to persuade voters and stakeholders of the need for reform and, in particular, to communicate the costs of non-reform. Where, as is often the case, the costs of the *status quo* are opportunity costs, they tend to be politically invisible, and the challenge is all the greater. This communications challenge points to the need for policy design to be underpinned by solid research and analysis, which serves both to improve the quality of policy and to enhance prospects for reform adoption. Partly for these reasons, the case studies suggest that successful structural reforms take time: the more successful reforms in the study generally took over two years to prepare and adopt, whereas many of the least successful reform attempts were undertaken in haste, often in response to immediate pressures. The cohesion of the government is also critical: if the government is not united around the policy, it will send out mixed messages, and opponents will exploit its divisions; defeat is usually the result. The case studies suggest that cohesion matters more than such factors as the state of the opposition or the government's parliamentary strength. Finally, while much of the political economy literature focuses on agency and the interplay of interests, the condition of the *policy regime to be reformed* also matters: some are more "ripe" for reform than others. Successful reforms of established policy regimes are often preceded by the "erosion" of the *status quo*; where the existing arrangements are well institutionalised and popular and there appears to be no danger of imminent breakdown, reform is far more difficult.

Scope, method and structure

The method of "focused comparison"

The present study employs a "focused comparison" approach to case-study research.[8] This method basically entails asking the same questions across a substantial number of cases in order to discern similarities among them that suggest possible generalisations. Findings generated in this way do not enjoy the level of formal verification that may be achieved via quantitative analyses of very large numbers of cases. However, the method of focused comparison offers significant advantages, chiefly by facilitating more detailed study of the context-dependent nature of certain relationships among variables. In particular, it permits a greater degree of "process-tracing" – *i.e.* tracing the links between possible causes and observed outcomes in order to assess whether the causal relationships implied by a hypothesis are evident in the sequence of events as they unfold. Because it examines specific cases in depth, rather than simply comparing data across cases, a focused case-study approach is better able to explore the policy process, to take account of institutional and political complexities and to explore more complex causal relationships, such as path dependence or the issues that arise when, for example, a given factor may favour adoption of a reform but hinder its implementation.[9] A case-study approach also permits exploration of variables that can be extremely difficult to quantify or code for inclusion in regression analyses. Econometric approaches tend to set aside intervening processes and focus on correlations between the *ex ante* and *ex post* states. Hence, they can rarely give an answer as to why a correlation is observed between reform outcomes and particular conditioning factors. The present study is thus a natural follow-up to the earlier econometric work by the OECD, in providing a means to explore more deeply some of the econometric findings and their implications.

Case selection

The term "structural reform" is here defined fairly broadly as referring to changes in structural policy settings directed at improving static or dynamic resource allocation in the economy.[10] When selecting cases for inclusion in the study, the approach has been to identify two cases for each country involved: one that was broadly successful and one that was judged to be less successful. For the purposes of the study, judgements about which cases were more and less successful are based on whether or not they were adopted and implemented, rather than on any *ex post* analysis of their economic impact. While this approach helped avoid selection bias and ensured that the cases reflected a range of reform outcomes, the preparation of the case studies themselves underscored the limited validity of such labels as "success" and "failure" when applied to reform episodes (Box 1.1). Both positive and negative lessons emerge from both more and less successful cases. The cases included in the study were chosen in an attempt to satisfy a number of other criteria as well:

- *Geographic coverage*. The cases include a mix of OECD countries, in terms of size, location, income level and institutional configuration, in an effort to derive lessons which would be relevant to the broadest possible range of OECD members.
- *Coverage of structural policy domains*. Because different types of reform may entail different sorts of political economy problems, it is important to address structural reform attempts in a number of different policy domains. However, the need for depth, as well as breadth, of coverage implies that the range of such domains should be limited. The episodes selected therefore concern three broad policy areas: product-market reforms, labour-market reforms and retirement reforms. The three domains chosen are all important fields, in which there has been a good deal of reform activity in the OECD in recent years (including both successful and unsuccessful reform attempts). They also remain, to a greater or lesser extent, on the economic policy agendas of virtually all OECD countries.[11]
- *Economic importance*. While most of the proposed cases concern reforms expected to have a broad economic impact, some more narrowly focused reforms are also included, particularly in the field of product-market regulation. These can be limited in terms of impact, especially where they concern a single sector, but they exemplify the particular set of political economy problems that arise when governments try to open up markets to competition.
- *Balance of contrasting outcomes within policy domains*. There is a rough, though not exact, balance between more and less successful cases in each domain; the results could be skewed by focusing too much on successes in one sphere and frustrated reform efforts in another.
- *Rough contemporaneity*. The cases concern reform attempts undertaken since 1990, so that they to some extent share a common economic and political "background", in terms of international trends and pressures, and present-day relevance to policymakers.[12]

With these criteria in mind, the terms of reference for twenty cases were agreed with the OECD members concerned (Table 1.1). The final list was also approved by the OECD's Economic and Development Review Committee (EDRC) as a whole. Where possible, some indication of each reform's impact is provided, but in some of the more recent cases, it is still too early for any definitive assessment. Nevertheless, the study is premised on the view that reforms selected for examination were potentially beneficial: some were clearly incomplete or imperfect, and a few changed so much in the course of the policy process that even some of their early supporters had doubts about the value of the "final product", but all of the initiatives undertaken represented attempts to alter structural policy settings in ways that would improve the efficiency of resource allocation in the economies concerned.

Box 1.1. **More and less "successful" reform attempts**

Although this study speaks at times of more and less successful cases, these labels do not represent a stark dichotomy. Instances of total success and outright failure are both very rare, and many unsuccessful reform attempts may nevertheless yield some progress or help to pave the way for successful reforms later on. Even an unsuccessful reform initiative may therefore represent a significant step forward. Nevertheless, identifying both more and less successful cases is important in order to avoid the potential selection bias that could arise from focusing predominantly or exclusively on either positive or negative experiences of reform. "Success" is here defined not in terms of any *ex post* assessment of ultimate economic impact (which in many cases is as yet unclear) but as the *adoption and implementation* of a reform that would help a country achieve certain desirable goals, such as fiscal sustainability, enhanced competition or increased employment. An unsuccessful reform is understood *not* as a policy failure (*i.e.* an attempt to do the *wrong* thing) but as an attempt to undertake a desirable reform that either fails to be adopted or is adopted but not implemented.

Table 1.1. **Political economy of structural reform case studies**

Retirement reforms	Labour market reforms	Product-market reforms
France: the 2003 pension reform.	**United States**: the "PRWORA" welfare reform legislation of 1996.	**Australia:** power-sector reform, 1990-2004.
Mexico: reform of the ISSSTE pension system for federal employees in 2007.	**The Netherlands**: reform of disability insurance, 2002-06.	**Sweden**: postal reform, 1992-2000.
Poland: the transition from an unreformed PAYG system to a three-tier system in 1997–99.	**Italy**: the Treu (1997) and Biagi (2003) reforms.	**Germany**: drive to liberalise shop opening hours, 1999-2004.
Italy: the government's attempt to reform the pension system in late 1994.	**Spain**: labour market reforms of 1994 and 1997.	**Australia**: water reform, 1994-2004.
United States: the administration's 2005 proposals for Social Security reform.	**Germany**: the Hartz reforms, 2002-05.	**Spain:** attempts to open up the retail sector, 1995-2004.
Poland: the attempt to reform the farmers' social security scheme (KRUS), 2003-05.	**France**: the *contrat d'insertion professionnelle*, 1993-94.	**Netherlands**: proposals for partial, phased rent deregulation, 2004-07.
	Mexico: proposed reform of the labour law, advanced in 2002 but withdrawn in 2005.	
	Sweden: Reform of sickness benefit, 1991-2002.	

Two points should be made at the outset in light of this approach to case selection.

- The selection of two case studies with contrasting outcomes for each country limits the scope for deriving hypotheses about the impact of institutional configurations such as electoral systems or separation of powers. By definition, there will be one more and one less successful case for each country with a given set of political institutions. This is not a problem, since the study focuses on factors that are more readily influenced by policy makers' choices.
- The cases concern only reform initiatives that governments actually undertook; instances in which there were grounds for believing that reform was needed but no action was taken have not been considered, and this may relativise to some extent the conclusions that can be drawn from the study. Many of the most

serious political economy failures occur when resistance to change is so great that reform is not even attempted. This is important to bear in mind when comparing the findings presented here with other work.

In preparing each case study, an initial set of working hypotheses about what happened, and why, was formulated on the basis of available data and published primary and secondary sources. These preliminary ideas were then discussed with officials, experts, representatives of the social partners and other stakeholders in the country concerned, including, wherever possible, individuals directly involved in the policy process during the episode under study. The initial analysis was then revised in light of these discussions and written up following a common template to facilitate comparison. These draft case studies were then discussed by the EDRC, which provided an opportunity for additional feedback, particularly from the countries concerned; the cases were then revised again in light of this input. Although the case studies could not have been prepared without the help of national authorities in clarifying issues and facts, the interpretations and assessments are those of the OECD Economics Department.

Screening the results: a statistical check

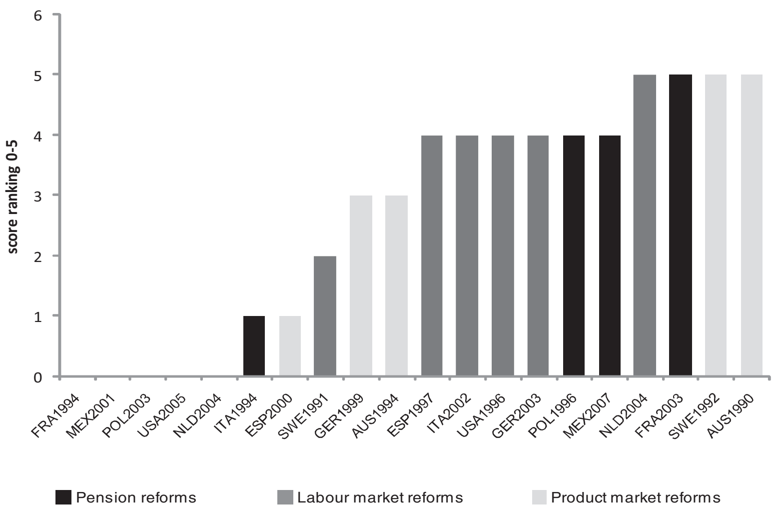
Though the case-study evidence does not permit rigorous statistical assessment of potential linkages between reform outcomes and the factors analysed in the case studies, it is possible to cross-check the lessons identified in the qualitative analysis using a relatively simple set of correlations constructed on the basis of the cases (Box 1.2). To this end, a synthetic indicator of reform outcomes has been constructed across the 20 episodes, and Spearman rank correlations have been calculated to measure the strength and direction of the links between reform outcomes and individual conditioning factors. The rank correlation approach is well suited to use with small samples.

The indicator reform outcomes has been developed on the basis of the evidence presented in the case studies, scoring the reform initiatives examined in the case studies from 0 to 5 by summing their scores on three criteria:

- *Adoption* of the reform proposal is scored from 0 to 2, where 0 signifies a failure to adopt, 2 reflects the adoption of all or nearly all of the proposal, even if subject to minor modifications and concessions, and 1 stands for intermediate cases, where adoption was very partial.
- *Implementation* success is also scored from 0 to 2, again reflecting the range from implementation failure (or reversal of the reform) through partial implementation to full implementation of the measures adopted.
- The *follow-up* to the reform is scored, with 0 signifying no further reform progress as a result of the episode and a score of 1 applied in those instances where the evidence suggests that a reform proposal (whether adopted and implemented or not) contributed to subsequent reform progress in the same field.

This indicator is clearly rather crude, but it has the advantage of being coded on the basis of fairly clear, simple criteria. The construction of a more elaborate indicator would have required more complex and subtle judgments and would thus have introduced a greater degree of subjectivity into the coding. Figure 1.1 shows the reform outcome scores of the 20 cases.

Figure 1.1. **Reform scores across 20 cases**



In general, the signs of the correlation coefficients for the aggregate indicators are as expected and are statistically significant across the 20 cases. Many of the specific process/design variables are also significant at the 5 or 10% levels across the full set of cases, even though not all are significant for the individual policy domains. The most important results are summarised in Table 1.2, and their implications are considered throughout the discussion that follows. The full results are presented in Table A1.1 in the Annex. As Table A1.1 shows, some variables that are not discussed in the foregoing analysis were tested in order to ensure that the null hypothesis of no linkage to reform outcomes could not be rejected. It is important to emphasise that the data used in the correlations add no "new" information to the synthesis: the statistical exercise is intended not to extend the study but as a means of screening its major conclusions.

The very high correlations reported in Table 1.2 doubtless reflect in large part the fact that many of the individual factors explored are closely related to, and highly correlated with, one another. If the data were suitable for a regression analysis or other more sophisticated techniques, it would be possible to untangle these relationships and the apparent impact of the individual variables would probably be reduced in many cases. Since this is not possible, one can only take note of such cross-correlations among independent variables and observe that many of them clearly tap into the same underlying information.

Box 1.2. **Screening the case-study hypotheses: the construction of the indicators**

The individual factors influencing reform outcomes and discussed in this study have been coded, using binary (0/1) or simple rank-order (0-2) values to score each episode with respect to the given factor. For example, with respect to electoral mandates, a score of 2 is assigned where the government could claim a clear mandate for reform; a score of 0 signifies a reform for which there was no mandate; and a score of 1 is applied to intermediate cases, where the government's claim to a mandate was credible but still in some way qualified or contested. Although the case studies provide the evidence on which the codings are based, they do involve a degree of subjective judgment. The variables have therefore deliberately been kept as simple as possible (binary or 0-2), again in order minimise any potential bias that such judgments might introduce.[1] The individual factors have all been coded in such a way that a higher score is expected to be correlated with a higher probability of success. Definitions and details can be found in the Annex.

Aggregate indicators have also been constructed in order to summarise the impact of a number of related factors by broad areas: political cycles, macroeconomic cycles and so on. These are calculated by simply summing the individual scores on the relevant individual factors operationalised as described in the previous paragraph. See the Annex for more detail.

Finally, broad indicators of policy reform (changes in overall structural policy settings) in each of the three domains were constructed in an effort to capture the larger reform "environment" in which specific reform initiatives were undertaken. These are based on the synthetic indicators of policy settings developed by the OECD Economics Department (see the Annex for details of their construction) and they are intended to reflect the intensity of reforms in each domain.[2] They provide a basis for looking at interactions between reforms in different domains and also for assessing whether or not a given reform was undertaken in the context of a broader reform drive or as a one-off.

The data used for scoring the indicators come chiefly from the case studies. However, where variables are readily quantifiable (for example, data on growth, unemployment and fiscal balances), other OECD and World Bank data were also used. Data sources are discussed in greater detail in the Annex. Although these additional data were used, it is important to stress that all data employed concern only the episodes under study: the Spearman correlations are not a method for assessing whether the case-study findings are generalisable to other episodes but rather a screening and cross-check device to ensure that the case studies really do lend support to the hypotheses derived from them.

1. More complex ordinal rankings would require finer judgements. In the absence of clear, agreed criteria for making such finely grained judgements, this would increase the scope for subjective bias.
2. The policy indicators are coded in such a way as to capture the intensity of ongoing policy reforms in the three domains at the time any given reform was adopted. The indicators used are the following: *i*) a composite OECD product-market reform indicator covering deregulation in seven non-manufacturing sectors; *ii*) an average indicator for labour-market reform covering reforms of the unemployment benefit system and employment protection legislation; and *iii*) a measure of pension reform intensity based on changes in the implicit tax rate on older workers.

Table 1.2. **Spearman rank correlations**

	Labour-market reforms		Pension reforms		Product-market reforms		Reforms in all domains	
Political conditions								
Clear mandate for reform	0.786	**	0.783	*	0.539		0.597	**
Government cohesion	0.675	*	0.906	**	0.420		0.680	**
Economic cycles								
Economic trigger (aggregate)	***-0.644***	**			***0.487***		***-0.039***	
Ongoing fiscal consolidation[1]	0.068		-0.533		-0.630		-0.379	*
Policy interactions								
Labour-market reforms	***0.060***		***-0.544***		***0.000***		***-0.114***	
Pension reforms	***-0.834***	**	***0.889***	*	***0.258***		***0.284***	
Product-market reforms	***-0.423***		***0.866***		***0.894***	**	***0.381***	
Reform process								
Scope and timing (aggregate)	***0.427***		***0.188***		***0.970***	**	***0.554***	**
Time taken in preparation of reform	0.447		0.763	*	0.399		0.553	**
Exogenous event as trigger for reform	-0.410		-0.429		0.840	**	-0.032	
"Ripeness" of policy regime for reform	0.900	**	0.853	**	0.105		0.599	**
Communication (aggregate)	***0.842***	**	***0.429***		***0.493***		***0.592***	**
Communication of costs of *status quo*	0.907	**	0.533		0.539		0.614	**
Government leadership	0.907	**	0.539		0.853	**	0.699	**
Clear "ownership" of the reform	0.761	*	.		0.320		0.379	
Dealing with opponents (aggregate)	***0.722***	*	***0.627***		***0.682***		***0.702***	**
Emergence of new actors as force for reform	0.665		0.426		0.804		0.636	**
New role for opponents under reform	0.363		0.905	**	0.539		0.578	**
Activation of winners in support of reform	0.617		0.544		0.000		0.360	*

* significant at 10% level of confidence; ** significant at 5% level of confidence.

1. Current primary deficit down by at least 1% of GDP on previous year.

Source: OECD calculations, based on case studies, OECD and World Bank data.

Notes

1. See, in particular, Duval and Elmeskov (2005) and Høj *et al*. (2006). A summary of the latter appears as chapter 7 of OECD (2007).
2. For overviews of this literature see, in particular, Alesina and Perotti (1994); Williamson (1994); Rodrik (1996); Drazen (2000); and IMF (2004).
3. The Department has employed a case-study approach before; see OECD (1988).
4. This emphasis is apparent in the overviews provided in Alesina and Perotti (1994); Williamson (1994); and Rodrik (1996).
5. The distinction originates with Balcerowicz (1995), who sees periods of "extraordinary politics", associated with such events as the fall of communism, as critical in creating conditions for radical, rapid and comprehensive reforms.
6. Grindle and Thomas (1991); Nelson (1990a, 1990b; 1994); Rodrik (1994); Tommasi and Velasco (1995).
7. For some important exceptions, see Nelson (1997); James (1986, 1993). Pension reform has generated a substantial literature; see, in particular, Myles and Pierson (2001); James and Brooks (2001); OECD (2004); Immergut *et al*. (2007); and Bonoli and Palier (2007). On labour markets, see Saint-Paul (1996, 1998), Elmeskov *et al*. (1998); Samek Lodovici (2000) and Ochel (2008).
8. See George and Bennett (2005) for details. This is broadly the approach taken by the authors contributing to Williamson (1994) and Immergut *et al*. (2007).
9. For more on the benefits and limitations of this method, see George and Bennett (2005:17-32).
10. This follows Koromzay (2004).
11. A deliberate decision was taken to avoid fields such as healthcare, where there is little or no consensus regarding OECD "best practice".
12. A study concentrating on, say, the 1960s or 1970s, would probably give greater attention to issues like financial and trade liberalisation. It would also confront a problem insofar as the political systems and policy processes of many members have changed fundamentally since then, raising questions about how relevant the study's findings might be.

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Annex 1.A1

Statistical methods and data sources

Introduction

Previous work on political economy by the Economics Department has employed econometric methods, relying on time-series data covering a large sample of OECD economies over an extended period of time. By contrast, the present study looks at twenty specific reform episodes in ten OECD countries at different points in time.[1] Although the case studies are not suitable for econometric analysis, it is possible to use relatively simple statistical tests to ensure that the hypotheses derived from the case studies stand up to a more rigorous quantitative approach. To that end, a data set has been constructed on the basis of the case studies. These data add no new information to the synthesis: the statistical exercise is used not to extend the study but as a means of screening its major conclusions. It is also important to acknowledge that, since most of the data are coded on the basis of the case studies themselves rather than drawn from external sources, there is an element of subjective judgement in the coding. In order to minimise any potential bias arising from such judgements, the variables have been kept as simple as possible: most are binary or very simple ranked ordinal values, rather than continuous, and the criteria for coding have been kept as simple as possible. Given the nature of the data, the most appropriate way to explore the links or influences across variables is to use simple statistical screening methods, such as Spearman rank correlations. These measure the direction and strength of the relationship between pair-wise variables (the outcome of reforms and individual political factors).

This annex describes the methodological choices involved in screening the statistical correlations between reform outcomes and the political economy factors analysed in the case studies. The first section describes the approach used to code the qualitative information drawn from the case studies for use in the rank correlations, as well as the coding of economic and political economy variables drawn from other sources. The second section explains the method – Spearman rank correlations – used to screen the links across ranked ordinal variables.

Construction of the indicators and data sources

The following indicators have been developed to translate qualitative information into quantitative data based on ordinal values, either binary or rank-ordered. In some cases, continuous time-series data have been converted into ordinal values so as to identify specific episodes during the reforms' adoption/implementation, while at the same time ensuring homogeneity across variables. The indicators have been constructed to reflect the political economy hypotheses discussed in the analysis.

Synthetic indicator of reform outcomes

A synthetic indicator of policy outcomes has been developed on the basis of the case studies, scoring the reform initiatives examined in the case studies from 0 to 5 by summing their scores along three dimensions:

- *Adoption* of the reform proposal is scored from 0 to 2, where 0 signifies a failure to adopt, 2 reflects the adoption of all or nearly all of the proposal, even if subject to minor modifications and concessions, and 1 stands for intermediate cases, where adoption was judged to be very partial.
- *Implementation* scores depend in part on the scores for reform adoption. For reforms with an adoption score of 2, implementation success is scored from 0 to 2, again reflecting the range from implementation failure (or reversal of the reform) through partial implementation to full implementation of the measures adopted. However, where reform adoption was partial, implementation is scored as 0 or 1.[2]
- The *follow-up* to the reform is scored, with 0 signifying no further reform progress as a result of the episode and a score of 1 applied in those instances where the evidence suggests that a reform proposal (whether adopted and implemented or not) contributed to subsequent reform progress in the same field.

Political cycle indicators

The following variables concern the political conditions in which the reform was initiated, including the strength and cohesion of the government, its mandate and the electoral cycle.

- *Government mandate (0-2)*. A score of 2 is assigned where the government has a clear electoral mandate for reform, 1 is assigned where its claim to a mandate is unclear and 0 applies in cases where no such mandate exists. The scoring is based on the case studies.
- *Stable political time horizon (0-4)*. The variable indicates the number of years left in the government's current term. Only full years are counted. "0" is scored in election year and n-1 in the year after the election with n= length of term. Data are taken from World Bank (2007).
- *Government control of parliament (0-3)*. This indicator measures the strength of the government vis-à-vis parliament and opposition parties. This aggregate indicator is the sum of scores on three binary variables drawn from World Bank (2007), which have been coded as follows. A score of 1 is assigned if the government commands a majority (50%+1) of the seats in the lower house. A further score of 1 is assigned if the executive commands an absolute majority in all legislative chambers with law-making powers in respect of the reform. A third dimension is scored as 1 unless the main opposition holds a majority in one or more legislative chambers.[3]
- *Government cohesion (0/1)*. This variable is coded 0 if the case study shows clear evidence of government divisions over the reform and 1 otherwise.
- *Government composition (0-2)*. This indicator is based on different but exclusive cases. A single-party government is coded as 2. A "dominant-party coalition", in which one party holds 40% of the seats in the lower house, is coded as 1. A more

fragmented coalition is scored as 0. These data have been drawn from World Bank (2007) but corrected in some cases by the Economics Department.[4]

Macroeconomic cycle indicators

This set of indicators includes those constructed in connection with the Department's earlier econometric work, as well as new indicators developed to capture those elements of the economic cycle that could have influenced the adoption of reforms in the cases under study. Unless indicated otherwise, the sources for these variables are Høj *et al.* (2006) and OECD (2008a).

- *Economic crisis (0/1)*. If the magnitude of the estimated output gap exceeds -3%, the case is coded as a crisis. Of course, the output gap may lag behind perceptions of a slowdown based on annual growth rates, since the output gap may take some time to turn negative after growth falters.
- *Economic downturn (0/1)*. The downturn variable is coded as 1 where the year of the reform sees at least two consecutive quarters of negative economic growth. A lagged downturn variable is likewise coded as 1 if the previous year saw at least two quarters of contraction.
- *Economic upswing (0/1)*. A value of 1 is recorded for both of the first two years of positive growth following a recession.
- *Economic trigger (aggregate)*. This aggregate indicator is the sum of the economic crisis variable and the economic downturn variables for the current and previous years.
- *Large increase in unemployment rate (0/1)*. This variable is set to 1 if the change in the unemployment rate is positive and greater than a threshold value, defined as the average change in unemployment rates from 1975 to 2007 within each country. The reference threshold is country-specific, because political resistance to, or support for, reforms is more likely to be sensitive to changes in the unemployment rate that are large by the standards of the country's recent past, whether or not they would be considered large in other OECD economies.[5]
- *High level of unemployment (0/1)*. A value of 1 is assigned if the unemployment rate at the time of the reform is greater than 70% of the maximum value reached over the 1975-2007 period for a given country.
- *Falling unemployment (0/1)*. This is indicator is set to 1 if the unemployment rate has fallen over the year prior to the reform.
- *High fiscal pressure (0/1)*. Fiscal pressure is observed (score = 1) if the ratio of net government lending (including interest payments) to GDP is greater than 80% of the maximum deficit observed over the 1975-2007 period for the country in question.
- *Weak fiscal position (0/1)*. A score of 1 applies if the primary balance is positive; otherwise, this is coded as 0, reflecting the limited scope for compensatory measures to soften opposition to reform.
- *Deterioration in primary deficit*. A score of 1 is assigned if the ratio of net government lending to GDP (excluding interest payments) is rising.

- *On-going fiscal consolidation*. If the primary deficit (excluding interest payments) as a percentage of GDP has fallen by more than 1 percentage point on the previous year, a score of 1 is assigned
- *Fiscal recovery*. When the primary balance has been positive for two consecutive years, a score of 1 is assigned.

Interactions with other policy reforms

These indicators seek to capture the broader reform "environment" in which the cases are set. As such, the indicators of policy reforms cover (where possible) different areas/sectors in each policy domain and are intended to reflect the degree of reform effort or the "intensity" of reforms in each domain. They use the synthetic indicators of policy settings developed by the OECD Economics Department. The intensity of reforms is coded as follows:

- When the reduction (improvement) in a reform indicator score is greater than 80% of the maximum variation observed in that country, a score of 3 is assigned, indicating a major reform effort.
- When the reduction (improvement) falls between 40% and 80% of the maximum variation observed, a score of 2 is assigned.
- A score of 1 is assigned when the variation is between 0% and 40%.
- A score of 0 applies when the variation is null or negative.

The indicators employed for this scoring are set out below.

Labour policy indicator

This policy indicator reflects reforms to current systems of unemployment insurance and employment protection legislation that have taken effect. The indicator is calculated as an average of:

- the gross unemployment benefit replacement rate for low-income workers (67% of average production worker earnings) in the first year of unemployment;
- the generosity of long-term unemployment benefit (in the fourth and fifth years of unemployment) relative to average spells of unemployment; and
- the summary indicator or the stringency of employment protection legislation for all types of contract (measured as the average of indefinite and fixed-term contracts).

The data for these indicators are taken from OECD (2008b).

Product market indicator

The broad policy reform indicator for product-market regulation is a summary indicator of regulatory impediments to product market competition in seven non-manufacturing sectors (gas, electricity, post, telecommunications, passenger air transport, railways and road freight). The indicator covers regulations on barriers to entry, public ownership, market structure, vertical integration and price controls. Data are taken from Conway and Nicoletti (2006).

Pension policy indicator

The indicator of pension policy reform reflects changes in both old-age pension systems and early retirement schemes. It is a simple average of:

- the implicit tax rate on continued work for workers aged 55-59 in early retirement schemes; and
- the implicit tax rate on continued work for workers aged 60-64 in both early retirement schemes and old-age pension systems.

The implicit tax rates as from 2000, estimated by the OECD Economics Department, are calculated so as to reflect reforms in policy parameters that have been legislated. This method excludes *de facto* cohort effects and phased-in effects; however, the data through 1999 reflect the actual implementation of legislated changes rather than their adoption, so reforms adopted with long transition periods are only reflected as they take effect. The break in the time series is non-negligible, since most pension reforms are phased in over an extended period. The original data on implicit tax rates on continued work for various age groups are described in detail in Duval (2004); the actual data are taken from that source for earlier years and from OECD (2008c) for the period from 2003.

Because the parameters of the main old-age pension system determine the value of this indicator to a great extent, a significant reform of that system will of itself drive a significant change in this indicator. The pension policy indicator is thus of limited use in defining a "reform context" for the specific pension reforms addressed in the case studies in the way that the other indicators do. However, it provides a useful indicator for assessing interactions among reform processes in different domains.

Process and decision-making indicators

The variables described in this section are all coded on the basis of the case studies. Aggregated indicators are constructed to summarise broad areas of policy process or design, such as the time frame, communications and negotiation with opponents. These are simply the sum of the specific factors underlying them.

Time and scope of the reform

- *Preparation time (0-2).* This variable measures the time from the point at which the reform process is initiated until the reform is either adopted or rejected: more than one year = 2; 3 months to one year = 1; less than 3 months = 0.
- *Exogenous event as a trigger for reform (0-2).* Exogenous event(s) forced the government to act = 2; exogenous event(s) relaxed the constraints on reform = 1; no exogenous trigger = 0.
- *Reform "ripeness" (0/1).* For simplicity, the notion of a policy regime's "ripeness for reform" is coded purely on the basis of past attempts to reform it comprehensively or at the margins, whether these were thwarted, reversed or sustained. Where the reform under study is preceded by previous reform efforts, a score of 1 is assigned; otherwise, the value is 0.
- *Breadth (0/1).* Since some strands of the literature argue that broad reforms face stiffer opposition than narrowly targeted ones, a score of 1 is assigned if the

reform is targeted at a particular sector or group; reforms that are broad in scope (affecting the median voter significantly and directly) are assigned 0.

Communication and consultation

- *Awareness of the need for change (0/1).* A score of 1 is assigned if the evidence suggests a widespread understanding among relevant stakeholders of the costs of the *status quo*, whether or not there was a consensus on what should be done.
- *Government leadership (0/1).* A score of 1 is assigned to cases in which the government was strongly and publicly committed to reform; otherwise, this variable is coded as 0.
- *Consensus building institutions (0/1).* If the government relies on specialised commissions or other consensus-building institutions to win adoption of the reform, this indicator is scored as 1.
- *"Ownership" (0/1).* Clear "ownership" of the reform by an identifiable individual, group or institution is coded as 1; otherwise 0.

Dealing with opponents

- *Corporatist processes (0/1).* If formal corporatist negotiations involving unions and employers formed part of the policy process, this variable is coded as 1; otherwise, it is 0.
- *Acquired rights (0/1).* This variable is scored as 0 where acquired rights are violated and 1 where they are respected.
- *New actors (0/1).* A score of 1 indicates that reform progress was facilitated by the emergence of new actors and/or institutions as the reform process unfolded.
- *Opponents (0/1).* This variable is scored as 1 if the reform offered opponents a new role or new opportunities that partly offset the costs of reform to them.
- *Activation of winners (0/1).* If potential winners from a given reform actively lobbied in support of it, this variable is coded as 1.

Spearman rank correlations

Definition

The most appropriate method for measuring the degree of correlation between ordinal values is the Spearman rank correlation. In principle, the Spearman correlation (ρ) is simply a special case of the Pearson product-moment coefficient, in which two sets of data (X_i and Y_i) are converted to rankings x_i and y_i before calculating the coefficient. In practice, however, a simpler procedure is normally used to calculate ρ. The raw scores are converted to ranks, and the differences d_i between the ranks of each observation on the two variables are calculated.

If there are no tied ranks, *i.e.* if $\neg\exists_{i,j}(i \neq j \wedge (X_i = X_j \vee Y_i = Y_j))$

then ρ is given by:

$$\rho = 1 - \frac{6\sum d_i^2}{n(n^2-1)}$$

where:

$d_i = x_i - y_i$ = the difference between the ranks of corresponding values X_i and Y_i, and

n = the number of values in each data set (same for both sets).

Test of significance

To test the significance of the Spearman rank correlations, the estimated values have been tested against the null hypothesis (H0). The tests were run at both 10% and 5% confidence levels to ensure that the estimated correlations were significantly different from zero.

Table 1.A1.1. **Spearman rank correlations**

	Labour-market reforms		Pension reforms		Product-market reforms		All reforms	
Political cycles								
Clear mandate for reform	0.7862	**	0.7833	*	0.5394		0.5972	**
Stable political horizon	-0.4521		0.3752		-0.0758		-0.1038	
Government strength *vis-à-vis* parliament and opposition	0.3567		0.3947		-0.5523		0.0781	
Government cohesion	0.6751	*	0.9058	**	0.4201		0.6797	**
Government composition	-0.4826		0.3015		0.1112		-0.0257	
Economic cycles								
Economic factors (aggregate)	***-0.644***	**	***.***		***0.487***		***-0.039***	
Major crisis	0.177		.		.		0.123	
Economic downturn	-0.423		.		0.426		0.000	
Economic upswing following adoption	-0.531		-0.135		0.539		-0.087	
Unemployment factors (aggregate)	***-0.303***		***-0.048***		***0.564***		***0.039***	
Falling unemployment	0.363		-0.213		-0.405		0.010	
High level of unemployment	-0.531		-0.533		0.539		-0.245	
Rising unemployment	0.000		0.426		0.320		0.223	
Fiscal factors (aggregate)	***-0.317***		***-0.091***		***0.379***		***-0.047***	
High level of fiscal pressures	-0.531		-0.539		0.426		-0.178	
Rising deficit	-0.293		0.302		0.402		0.098	
Weak fiscal position	0.060		0.302		0.426		0.254	
Fiscal consolidation	0.068		-0.533		-0.533		-0.379	*
Fiscal recovery	0.270		-0.135		-0.405		-0.045	
Policy interactions								
Labour-market reforms	***0.060***		***-0.544***		***0.000***		***-0.114***	
Pension reforms	***-0.834***	**	***0.889***	**	***0.258***		***0.284***	
Product-market reforms	***-0.423***		***0.866***		***0.894***	**	***0.381***	
Process and design of reforms								
Scope and timing (aggregate)	***0.427***		***0.188***		***0.970***	**	***0.554***	**
Time taken in preparation of reform	0.447		0.763	*	0.399		0.553	**
Exogenous event as trigger for reform	-0.410		-0.429		0.840	**	-0.032	
"Ripeness" of policy regime for reform	0.900	**	0.853	**	0.105		0.599	**
Communication (aggregate)	***0.842***	**	***0.429***	**	***0.493***		***0.592***	**
Communication of costs of *status quo*	0.907	**	0.533		0.539		0.614	**
Government leadership	0.907	**	0.539		0.853	**	0.699	**
Use of consensus-building institutions	0.423		0.302		-0.101		0.224	
Clear "ownership" of reform	0.761	*	.		0.320		0.379	
Dealing with opponents (aggregate)	***0.722***	*	***0.627***		***0.682***		***0.702***	**
Formal concertation with social partners	0.423		0.533		0.320		0.438	
Respect for acquired rights	0.000		0.533		1.000		0.260	
Emergence of new actors as force for reform	0.665		0.426		0.804		0.636	**
New role for opponents under reform	0.363		0.905	**	0.539		0.578	**
Activation of winners in support of reform	0.617		0.544		0.000		0.360	*

* Significant at 10% level of confidence; ** significant at 5% level of confidence.

Source: OECD calculations, based on case studies; OECD (2008a), *OECD Economic Outlook*, Vol. 2008/2, No. 84, OECD, Paris; and World Bank (2007), *Database of Political Institutions*, World Bank, Washington, DC.

Notes

1. See especially Duval and Elmeskov (2005); and Høj *et al.* (2006). IMF (2004) is based on a similar approach to this earlier work by the Secretariat.

2. The logic here is that a reform was not fully implemented if large elements of it failed to win adoption, even if those measures that were adopted were also implemented in full.

3. Clearly, a score of 1 on the second dimension precludes a score of 0 on the third; however, the third dimension distinguishes cases of parliamentary fragmentation from episodes in which the government faces at least one chamber effectively controlled by its opponents.

4. In the Swedish (1991) and Spanish (1994 and 1997) cases, the Bank's database records single-party minority governments as majority coalitions, because they were sustained in office by minor party support in parliament. However, these were not coded as coalitions for the present study: no coalition programme was agreed, no other parties joined those governments and, in practice, the particular combination of non-government parties on which the cabinet relied to adopt legislation varied across time and from issue to issue. The literature generally treats these as one-party minority governments rather than majority coalitions. Mexico has been recoded as having a one-party government in both cases, because, although members of other parties worked with the Fox and Calderón administrations, there was no coalition between the PAN party and its rivals. Italy's governments have been re-coded as coalitions for all cases, reflecting the continued importance of the distinct political parties that made up the two broad coalitions contesting power in the elections of 1994-2000; the World Bank database treats the "Olive Tree" coalition and the "House of Freedoms" coalition as one-party governments. Again, both popular discussions and the scholarly literature continue to regard them as multi-party coalitions. Finally, France is coded as a one-party government in 2003, reflecting the creation of the Union for a Popular Majority (originally the Union for a Presidential Majority) in 2002.

5. In previous econometric work by the Department, this threshold was defined as twice the standard deviation observed in 20 OECD countries.

Chapter 2

Key determinants of successful structural reform

Introduction

This chapter presents the main lessons that seem to emerge from 20 studies of structural reform episodes in member countries completed during 2007-08.[1] While this exercise has not yielded any one-size-fits-all "toolkit" for reformers, nor even suggested that such a toolkit exists,[2] it does point to a number of striking regularities in the way reform processes unfold. The chapter proceeds as follows. The next section considers the role of political and economic factors exogenous to the reform processes under study, though not necessarily to the political process as a whole. The discussion then turns to issues related to the scope and timing of reform, particularly speed and sequencing. The third major section deals with questions of consultation and public communication, and the fourth set of issues concerns the way reformers deal with actual or potential opponents of reform.

Exogenous factors

Many of the factors that affect the prospects for reform are clearly exogenous to the reform process itself. These include both political/institutional and economic variables. Some, such as demography, are largely beyond the influence of policy makers, except possibly over the very long run, while others, like government coalition agreements, are products of political choice but may still be understood as exogenous to the reform, since they cannot easily be altered in the short term and they therefore define the context in which reform proposals are advanced and debated. The evidence of the case studies examined here broadly supports the view that political-institutional and economic framework conditions are critical to the prospects for reform.[3] The case studies underscore the importance of electoral mandates and sound public finances in providing a favourable context for structural reform. The importance of such conditioning variables implies that circumstances and timing are important, but also that, where framework conditions are not propitious, preparatory action may lay the groundwork for later reform. If, for example, fiscal weakness is an impediment to desirable product- or labour-market reforms, then the determination to pursue such reforms may represent yet another reason to pursue near-term fiscal consolidation.

The political context

Elections matter

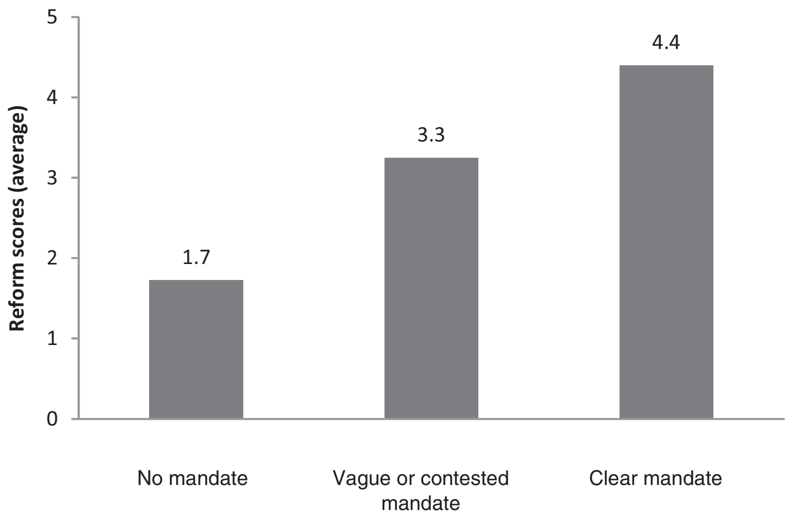
One of the strongest findings to emerge from the case studies is that governments are likely to achieve more, at lower cost, when the architects of reform can credibly claim an *electoral mandate* for reform and the issue is still salient in voters' minds (*France, Poland and Mexico: pensions; Germany and Spain: labour market; United States: welfare reform; Netherlands: disability insurance*). Where newly elected or re-elected governments[4] act without a mandate for reform, or on the basis of only vague commitments to address particular problems, voters and other actors are far less likely to accept what they propose (*France: labour market; Italy: pensions and labour market*[5]*; Poland: farmers' social insurance; Sweden: sickness insurance; United States: pensions; Mexico: labour law*[6]; *Netherlands: rent regulation*). The claim that electoral mandates for reform are critical stands in contrast to some previous research, which suggests that they are not a necessity. Williamson and Haggard (1994), for example, point to many examples of successful reform programmes implemented by governments doing the opposite of what they had promised to do when running for office – usually governments elected on populist platforms which then pursued fiscal consolidation and market reforms. However, these cases generally concern reforms undertaken in response to crises, and the reforms in question often generated substantial benefits quickly, since they were usually aimed at macroeconomic stabilisation.[7] Reforms that create large numbers of winners rapidly may win acceptance *ex post* even if they faced strong *ex ante* opposition, but since most structural reforms are unlikely to generate large pay-offs as quickly as a successful stabilisation, securing public acceptance of such reforms beforehand would seem to be all the more important.

The evidence of the case studies suggests that the importance of electoral mandates may vary across policy domains. The need for a mandate stands out most strongly in respect of pension and labour-market reforms, but the evidence for it is rather weaker in respect of product-market reforms, possibly because many of them had a sectoral focus and some were technically quite complex. Their direct impact on most households was not immediately apparent, since it was sometimes difficult to persuade the public of the benefits to consumers arising from reforms that would eliminate producers' rents, and the conflicts of interest involved did not always break down along party-political lines.[8] Regulation of retail market entry and opening hours in Spain and Germany, for example, does not appear to have been a salient issue in general election campaigns, nor was postal reform in Sweden. Power-sector reform did figure prominently in some Australian state elections, but electoral controversies were focused almost wholly on privatisation; other aspects of this very complex reform did not capture the electorate's attention. The only product-market episode in which electoral factors loomed large was rent deregulation in the Netherlands, the initiative that had, potentially at least, the broadest direct impact on voters of any product-market reform in this study. The rank correlations confirm both the importance of clear mandates for reform and the differences in the relevance of this factor outlined above (Table 1.2 and Figure 2.1).

The case studies also suggest that the timing of a reform within the *electoral cycle* can be important. Governments generally do seem to have a window of opportunity to move on reforms early in their mandates: in the case studies, eight of the ten reforms that were both adopted and sustained were passed within the first two years of the government's term of office (*France, Mexico: pensions; Italy, Germany and Spain: labour market; United States: welfare reform; Netherlands: disability insurance; Sweden: postal reform*).[9] The fact that six of the eight cases just cited are also referenced in the previous paragraph suggests that this finding is closely linked to the issue of electoral mandates: it pays to act where those mandates are relatively fresh. The Mexican pension reform is particularly striking: the first attempt to adopt it failed largely because it was shortly before presidential and congressional elections, whereas a second attempt to pass the measure, immediately after the elections, was successful.[10] However, where the government is not seen to have a mandate for reform, prompt action may not help: in all three cases in which governments tried to adopt reforms within months of winning an election and failed, they had problems claiming a mandate for their proposals (*France: labour market; Italy and United States: pensions*). As noted above in connection with the Mexican pension reform, things can get difficult later on: approaching elections seem to have made legislators more risk-averse or undermined government cohesion in a number of other cases (*Mexico: pensions; France: labour market;*[11] *Mexico: labour law; Poland: farmers' social insurance; Sweden: sickness insurance, Netherlands: rent deregulation*). While there were two cases in which forthcoming elections were actually a *spur* to reform (*Poland: pensions; United States: welfare reform*), these were both instances in which specific circumstances prevailed: the evidence suggests that in each of these episodes, the electorate strongly favoured reform, and the major parties were fairly close to one another on the issue in question.

It may be significant that the cases do not point to a strong relationship between pension reform success and the *timing* of elections, whereas the labour-market reform episodes provided the strongest support for the hypothesis that it pays to act swiftly following an election.[12] While the number of cases is too small to generalise this finding with any confidence, these differences do make intuitive sense: pension reforms tend to focus on questions of long-term sustainability and to be adopted only after extensive consultation. They thus take longer to prepare and adopt, and they are in any case unlikely to generate significant pay-offs within a single election cycle. Moreover, although cross-party co-operation on pension reform proved to be the exception rather than the rule, the main axis of conflict in most cases was not party-political.[13] Labour-market reforms, by contrast, are often highly contentious but can, if adopted early enough in the cycle, begin to generate real benefits in time for the next election, so prospects of success appear to be better when governments act in the immediate post-election period.

Figure 2.1. **Reform mandates and reform scores**



While all the cases examined here concern reforms that were at least *attempted*, the electoral cycle may also affect governments' readiness to try to reform in the first place. They may simply undertake fewer reform initiatives when elections are approaching. However, recent econometric evidence concerning such pre-election "reform slowdowns" is mixed.[14] While it is clear that governments facing close re-election battles may not wish to launch potentially unpopular reforms too close to polling day, it is also the case that governments up for re-election will wish to be seen to perform on their earlier election promises (*United States: welfare*[15]). If facing probable defeat, they may push through last-minute reforms that limit to some extent their successors' freedom of action (*Poland: pensions*).[16]

Other political conditions matter but appear to be less important

Less important but still relevant is the state of the political opposition. In several cases, governments were able to pursue contentious reforms when the principal opposition parties were divided or otherwise in disarray (*France and Mexico: pensions; Italy: labour market; Australia: electricity*[17]). In several of the labour market episodes, resistance to reform was weakened as a result of divisions among or problems within the major trade unions (*Italy*[18]*, Germany and Spain: labour market*). However, a weak or divided opposition was clearly not a sufficient condition for success, since some reform attempts were thwarted even when opposition parties had been weakened by recent electoral defeats and internal conflicts (*France: labour market; Italy: pensions*). This finding is consistent with previous research elsewhere.[19] A look at the balance between government and opposition also suggests that government "strength", as measured by its legislative majority or lack thereof, is not always important: the more successful cases were roughly evenly split between reforms adopted by minority governments and those commanding parliamentary majorities. Likewise, half the reforms that were blocked were proposed by governments commanding sometimes heavy parliamentary or congressional majorities.[20] While reform can require much more negotiation under a minority government, it is also less likely to be reversed in cases where the opposition has cooperated in its adoption. The rank correlations tend to reinforce the sense that such factors as the government's command of a majority in parliament, the presence of a single-party government or a coalition with one strongly dominant party, and the strength of opposition parties are far from decisive: the relevant indicators were not significantly associated with reform outcomes and sometimes generated the wrong sign (Table A1.1).

The cases considered here provide little support for the notion that the political complexion of the government is an important factor affecting prospects for reform success overall.[21] As noted above, pension reform has not generally been a clear-cut left-right issue, and political orientation probably plays a small role for reforms in product markets, since the interest groups involved are often affiliated to a range of political parties.[22] However, the cases themselves suggest that there may be a "Nixon to China effect"[23] in respect of labour-market reforms: successful labour-market reforms were more often than not begun under centre-left governments, even if they were sometimes adopted with the co-operation of, or continued under, the centre-right (*Italy, Germany and Spain: labour market; United States: welfare reform*). At first glance, this might seem to contradict earlier econometric work suggesting that governments of the left undertake fewer reforms, particularly in respect of labour markets.[24] However, since the episodes here only concern reform attempts *undertaken* by governments, it is possible that governments of the left are both less likely to pursue labour-market reforms and more likely to succeed when they do pursue them. First, it may be that centre-left governments tend to pursue labour-market reforms only when the need for reform is most urgent.[25] Secondly, because left-wing governments generally have closer relations with organised labour, they may find it easier to reach agreement with unions on reform proposals.[26] Thirdly, where centre-left governments opt for reform, the trade unions may have few allies to support their opposition. In two cases, centre-left governments pursued labour-market reforms after growing impatient with union resistance and did so with the support, or at least acquiescence, of other parties (*Spain and Germany: labour market*). This left the unions isolated.[27]

The explanation for the "Nixon to China effect" appears to lie in information asymmetries about the relationship between policy instruments and outcomes: faced with a government reform proposal, voters cannot always be certain whether it is motivated by a desire to increase social welfare or by the government's wish to pursue partisan objectives and serve the particular interests of its own core constituents. Given the existence of such asymmetries, substantial policy change in a given direction may be more easily sustained if implemented by parties that would appear *ex ante* to be ideologically opposed to it.[28] Mistrust of ideologically driven policies seems to have been a factor in a number of the cases under study, where opponents of reform were able to use ideologically and politically loaded terms to frame proposed reforms in a way that would strengthen resistance to them, in part by making them appear far more radical than they were (*United States: pensions; Netherlands: rent deregulation; Australia: electricity*).

The involvement of different levels of government may shape the reform

Six of the cases reviewed have a significant "federal" dimension (*United States: welfare reform; Germany: retail and labour market; Australia: electricity and water; Spain: retail)*.[29] The US and Australian cases suggest that the capacity for inter-governmental co-operation in policy making can be an important framework condition for reforms with a significant federal dimension; if this capacity is weak, then strengthening it may have to be a part of the reform agenda, as it was in Australia in the early 1990s. Otherwise, the case studies do not point to clear, simple lessons about the interaction between inter-governmental policy making and reform. In three cases (*Germany: retail; United States: welfare reform; Australia: electricity*), sub-national governments exerted an important influence in both advancing and shaping the reforms eventually adopted. These cases also highlighted the potential for policy innovation and experimentation by sub-national governments to influence national-level reform debates. However, in a fourth case (*Germany: labour market*), the federal dimension proved a complicating factor when it came to reform implementation, and resistance from sub-national governments emerged as an important impediment to reform in two others (*Spain: retail; Australia: water*). The capacity of provincial and municipal governments to influence reform implementation also made it harder for the government to pursue rent reform in the Netherlands. While the central government controlled most policies concerned with the demand side of the market (chiefly rent subsidies and tax treatment of owner-occupiers), constraints on supply were largely the result of local authorities' actions (zoning and other land-use decisions).

In some respects, the Australian water reform is the most paradoxical episode: much of the impulse for reform came from the states, but it was conflict among the states and state reluctance to cede authority over water policy to national-level bodies that largely checked the reform's progress. In the two retail regulation cases (*Germany and Spain)*, the politics of reform at sub-national level were actually rather different from the national level – but in opposite ways: in Germany, it was the *Länder* that pushed for reform and the central government that was reluctant, whereas in Spain it has been the regions (the *Comunidades Autónomas*) that have resisted opening up the market. The issue, then, is not whether decentralisation aids reform or not, but rather when and where it is likely to facilitate reform. As the German and Spanish retail episodes suggest, this may be highly context-dependent.[30]

The economic context

The business cycle may not matter so much for the fate of reform attempts

While many reforms were initiated against a backdrop of poor performance, the cases do not point to a strong across-the-board link between current growth performance and governments' ability to secure *adoption* of reforms. Again, this result must be considered in light of the focus of this study on reform initiatives that governments have actually undertaken.[31] What the case studies suggest is that, granted a government is prepared to put forward a reform proposal, its prospects for securing adoption of that proposal do not appear to be strongly linked to the business cycle: reforms were roughly as likely to be adopted or blocked in cyclical upswings as in downturns. The rank correlations tend to reinforce this impression: none of the exogenous economic factors tested was strongly linked with reform *outcomes*, except for the aggregate variable for "economic triggers", the negative sign on which suggests that labour-market reforms are especially difficult in the midst of a severe downturn or crisis, and the fiscal consolidation variable, which is discussed below. The weak coefficients for the economic variables overall are consistent with the conclusion that macroeconomic performance, though probably important in determining whether and when reform initiatives are undertaken, has limited impact on governments' success in adopting and implementing those initiatives that they do attempt.

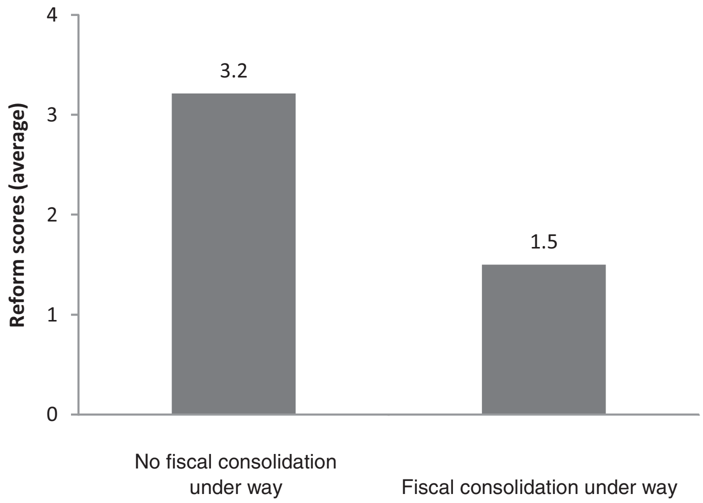
That said, the case studies do suggest some lines of analysis concerning the relationship between growth performance and reform in different domains that merit further exploration. First, whereas labour- and product-market reforms were typically initiated in periods of poor growth performance, if not crisis, pension reforms were undertaken by governments in economic conditions ranging from severe recession to strong growth. Since the costs and benefits of pension reform will be felt over the very long term, cyclical fluctuations would not be expected to shape the politics of pension reform much. By contrast, labour- and product-market reforms are aimed at improving current performance. Secondly, although the *adoption* of labour-market reforms does not appear to have been determined by the cycle, implementation appears to have been easier when it coincided with a recovery (*Spain: labour market; United States: welfare reform; Netherlands: disability insurance*). This observation is consistent with previous econometric work, which suggests that the most promising time to reform is immediately after a recession.[32] Germany's Hartz reforms are instructive: the positive effects on employment were substantial but did not materialise until sometime after the reforms were adopted; the Hartz measures remained unpopular and their role in improving the employment situation was not widely understood.[33]

Fiscal problems can create pressure for reform and yet make reform more difficult

Pressure on public finances, particularly when linked to some fairly binding constraint, like entry criteria for European Economic and Monetary Union (EMU) or constitutional restrictions on public debt, can provide an impetus to pursue structural reforms (*Italy, Poland and Mexico: pensions; Poland: farmers' social insurance*).

However, many structural reforms – particularly pension reforms – involve up-front fiscal costs, while the benefits are realised only later. A severe fiscal squeeze may therefore make reform harder to adopt and implement. Indeed, one of the most robust findings to emerge from recent econometric work on the political economy of structural reform is that sound public finances tend to be associated with more reform.[34] A weak fiscal position also makes it harder to find the resources that may be needed to provide adequate compensation or transition arrangements for those who stand to lose from structural reforms, and governments with limited political capital may opt to "spend" it on fiscal consolidation rather than structural reform. The case studies reviewed here tend to be congruent with these findings, as is clear from the negative sign on the (weakly) significant rank correlation for the fiscal consolidation variable (Table 1.2 and Figure 2.2). The econometric literature suggests that fewer reforms are likely to be initiated by governments in weak fiscal positions, so there may be a twofold effect of fiscal strain – reform attempts are less likely to be initiated *and* less likely to succeed.

Figure 2.2. **Reform scores and fiscal consolidation**



While the case studies provide no basis for generalising about whether governments undertake more or less reform with a healthier fiscal balance, they do suggest that the fiscal position can indeed affect prospects for success if a government undertakes a major reform initiative:

- In several cases, concessions that facilitated reform adoption were possible on account of prior improvements in the state of public finances (*Mexico and Poland: pensions;*[35] *Spain: labour market*). In others, difficulties in winning adoption were linked directly to a weak or weakening fiscal position (*United States: pensions; Italy: labour market*).
- The urgency of the fiscal situation matters. If immediate fiscal concerns rather than longer-term structural objectives are uppermost in policy-makers' minds, the design of the reform may be distorted by the need for rapid savings (*Italy: pensions; Poland: farmers' social insurance; Sweden: sickness insurance; United States: welfare reform*).

- Reforms driven by immediate fiscal needs may also prove harder to sustain once the fiscal pressure has eased, not least because they are often presented as necessary responses to a financial squeeze rather than desirable changes in structural policy settings (*Poland: farmers' social insurance; Sweden: sickness insurance*). The academic literature on the political economy of policy reform suggests that this is often a problem with crisis-induced reforms, whether they are prompted by fiscal strains or other pressures.[36]

The contrast between the reform of sickness insurance (SI) in Sweden in the early 1990s and the Dutch disability insurance reform of the early 2000s is instructive: fiscal considerations were significant factors in both reforms, but their impact on the reform process was not the same. The need for immediate fiscal savings was paramount in Sweden when the first SI reforms were adopted in 1991, and the reform was presented as a fiscal necessity. As the fiscal situation improved, there was growing pressure to reverse it. In the Netherlands, by contrast, fiscal pressures were not the principal drivers and the reform was debated more in terms of activation and labour-market objectives than fiscal ones. The more recent Swedish reforms to SI, which so far appear to have been very successful, are also consistent with this hypothesis: because they were adopted at a time when the fiscal position was fairly healthy, they did not impose such heavy up-front costs on beneficiaries as had the reforms of 1991, and they were designed with a focus on activation and the social costs of inactivity rather than fiscal concerns.

The link between structural reform and the state of public finances can be particularly visible in respect of reform of employment protection legislation (EPL). EPL and unemployment insurance (UI) may be seen as alternative ways of protecting workers against unemployment risk. On the whole, there appears to be a trade-off between them, inasmuch as countries with strict EPL tend to have less generous unemployment insurance systems and vice versa.[37] One obvious reform path for those seeking to lower EPL and reduce labour-market dualism would therefore be to combine relaxation of EPL with an increase in UI coverage. This possibility was indeed discussed in Italy throughout the period covered by the case study, but pressure on public finances limited the ability of successive governments to pursue such a compromise. A similar approach might also have facilitated reform in Spain, but there, too, the budgetary situation was tight. However, one reason labour-market reform in Spain was easier in 1997 than in 1993-94 was that public finances were healthier in the latter case. While fiscal discipline was still paramount, to ensure smooth entry into the first wave of EMU, the government could afford some tax and other concessions to encourage the use of the new permanent contracts and reduce reliance on fixed-term and other non-standard contracts.

Labour-market performance affects the nature of labour-market reforms

The political economy literature suggests that, although high *levels* of unemployment tend to increase the pressure for labour-market reform, a sharp *rise* in unemployment increases the likelihood of a "two-tier reform".[38] Since the value of employment protection rises with unemployment, regular workers, who tend to be the most organised segment of the labour force, have even greater reason to resist any weakening of EPL during a cyclical downturn. At the same time, because EPL tends to impede job destruction as well as job creation, governments may hesitate to relax EPL protections in the midst of a recession, for fear of even greater job losses. Consequently, reforms in such circumstances tend to focus on labour-market "outsiders" – new entrants, those on irregular contracts, the unemployed and others on benefit. The labour-market cases under review are largely consistent with this hypothesis (*France, Italy and Germany: labour market; Sweden: sickness insurance; Netherlands: disability insurance*).[39]

The exception to this generalisation is Spain: it is the only case in the study in which a government relaxed conditions for dismissing labour-market insiders at a time of rising unemployment.[40] In 1994, with unemployment still rising, the government moved to restructure severance procedures in an effort to reduce costs and to expand and clarify the grounds for "justified" individual and collective dismissals. Severance pay regulations remained unchanged, but even this limited reform marked an important watershed.[41] Moreover, it helped pave the way for further steps in 1997, including the introduction of a new indefinite contract with lower severance pay. While the case study identifies many different factors at work shaping the reform process, the most striking feature of the Spanish situation is that by 1993-94, labour market dualism had gone so far that the unemployed and those on non-standard contracts outnumbered regular workers, so there were strong electoral incentives to help more outsiders into secure employment, even if this came at a cost to employed insiders.[42] The Spanish case suggests that reform at the margins of the labour market can indeed weaken insider power and create an opening for deeper reforms to follow, but the experiences of the countries under study, as well as other OECD members, show that this process is not easy, automatic or quick.

External pressures tend to be felt most directly in product markets

It can be difficult to assess the role of external factors in shaping reform processes using a case-study approach, as many of the forces at work, such as trade liberalisation, the construction of the EU Single Market or policy shifts in other economies, are powerful but gradual. They shape the entire context within which economic policy debates take place. Their impact is therefore difficult to pinpoint in respect of any given reform debate, although recent econometric work consistently points to the importance of such international influences, particularly with respect to product-market liberalisation.[43] The evidence emerging from the case studies is consistent with these findings and, significantly, offers support for some of the causal mechanisms thought to underlie these relationships. On the whole, the influence of international factors was most visible in conjunction with product-market reforms. These factors included trade liberalisation and international competition (*Australia: electricity; Germany: retail*[44]), as well as international regulatory change, technological development and EU policies (*Sweden: postal reform*). Research and policy innovation elsewhere also prompted policy makers to look at new ways of doing things (*Australia: electricity; Sweden: postal reform*). In two pension-reform episodes, pressure from international financial markets played a role in spurring reform initiatives (*Poland and Italy: pensions*), and governments in a number of cases linked reform proposals to EMU or EU entry (*Italy: pensions and labour market; Spain: labour market; Poland: farmers' social insurance*). EU influences were most evident in connection with relatively "hard" policy instruments, like EMU, EU accession and European Court of Justice judgments. Softer forms of policy co-ordination, like the Lisbon process, tended to be used instrumentally – they provided tools for policy makers trying to legitimate changes in product- or labour-market policies that they believed were desirable.

Timing, scope and sequencing

The case studies suggest a number of issues to explore with respect to the timing and pace of reform, quite apart from the issues discussed above in connection with the electoral cycle. A substantial literature focuses on the sequencing or "bundling" of reforms, particularly in developing or transition countries. Since bundling has tended to be more common in cases of systemic transformation, when "big bang" reform packages are adopted (*e.g.* the start of the post-communist transition), or in response to severe crises, most of the reforms covered by this study have not been adopted as part of a single large package.[45] They tend instead to be sequenced, an issue on which several of the case studies cast light. Where bundling occurs, it usually involves multiple, closely related reform measures in a single domain rather than the combination of reforms across a number of distinct policy areas.

A "climate of reform" can facilitate progress on specific issues, particularly in product markets

The case studies suggest that individual reforms can be easier to pursue where they form part of a larger shift in structural policy settings; such reforms run with rather than against the grain of economic policy (*Sweden: postal reform; United States: welfare reform; Australia: electricity and water; Netherlands: disability insurance; France, Mexico and Poland: pensions*). Thus, when Swedish postal reform emerged on the political agenda, the country was already experiencing a broad shift towards opening up network sectors.[46] Both power and water reforms in Australia were launched in the context of, and largely shaped by, a broader microeconomic reform agenda, which was ultimately given formal institutional shape in the National Competition Policy. The Netherlands tackled disability insurance reform at a time when a number of other labour-market and social-insurance reforms were on the agenda.[47] The very high and significant score for the interaction between a given product-market reform and the overall "PMR reform environment", as measured by the change in the OECD indicators of product-market regulation (PMR) for seven non-manufacturing sectors around the time of the reform, reinforces this impression: it suggests that individual product-market reforms are more likely to be accepted as part of a wide-ranging reform process.

It may be difficult to pursue simultaneous pension and labour-market reforms

Policy interactions *across* domains appear to be weak, with one exception: the correlation coefficient shows a significant and negative sign for the relationship between labour-market reform outcomes and the indicator of on-going changes in pension policy. In short, it would appear that major pension reforms may make successful labour-market reforms significantly harder. Given the labour-market implications of many retirement reforms, major initiatives in both domains at once might be perceived as hitting workers with a "double-whammy": unions, with interests in both areas, would find it hard to accept major reforms in both, and governments might well accept that the political price of pursuing them together would be too high. This makes the Italian experience of the mid-1990s all the more remarkable, since the country did manage to pursue reforms in both domains, albeit only after making significant concessions to the unions in respect of both.

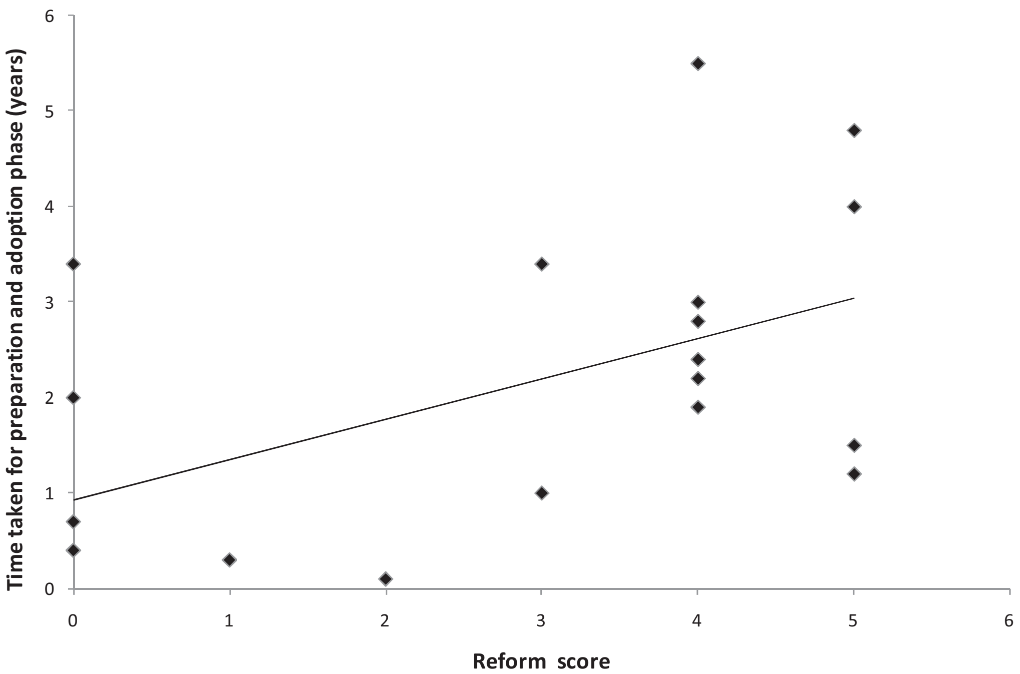
Events may open "windows of opportunity"…

Even in the absence of a recent electoral mandate, one-off events, such as crises or scandals, may expose weaknesses in the *status quo* and create an opportunity for reform. They may even result in a government having a clear mandate for reform in the absence of fresh elections. Crises or other "action-forcing" events can sharpen awareness of the need for change, shake up established interest coalitions or induce agents to accept reforms despite high levels of uncertainty about the post-reform environment (*Italy: pensions; Poland: farmers' social insurance; Sweden: sickness insurance and postal reform;*[48] *Spain: labour market*).[49] Alternatively, there may be developments that do not force the government to act but that reduce the impediments to reform by weakening its opponents or shaking up established interest coalitions (*Italy*[50] *and Germany: labour market; Mexico: pension reform and labour law;*[51] *Australia: electricity*[52]). However, such reforms, if adopted, can prove difficult to sustain once the extraordinary circumstances pass, unless they are based on longer-lasting shifts in agents' understanding of what is feasible or desirable (*Germany: labour market; Poland: farmers' social insurance*).[53] Significantly, exogenous events appear to have had least impact in respect of retirement reforms, which is perhaps what would be expected: given that they address the long-term sustainability of complex policy regimes that encompass most of the population, they tend to require long preparation and extensive consultation, making them less likely to be driven by current political or economic developments. Indeed, both the crisis-induced pension reforms in this study were thwarted (*Italy: pensions; Poland: farmers' social insurance*).[54] The correlation coefficients for the "exogenous triggers" variable provide some support for these impressions: the coefficient is both strong and significant for reforms in product markets (Table 1.2).

… but more haste can make for less speed

While it is important that policy makers seize reform opportunities when these arise, it is critical to bear in mind that successful reforms, particularly pension reforms, often have relatively long gestation times, involving a considerable amount of careful study and consultation (*France, Poland and Mexico: pensions; Italy: labour market; United States: welfare reform; Netherlands: disability insurance; Australia: electricity*). On average, the formulation and adoption of the reforms examined in the more successful cases took somewhat over two years – and this figure does not include the "pre-work" done in the many episodes in which problems and proposals had been debated and studied for years before the authorities set to work framing specific reforms.[55] By contrast, many less successful reform attempts were launched without adequate preparation (*Sweden: sickness insurance*[56]*; France: labour market; Italy: pensions*).[57] While governments should be ready to use political "windows of opportunity" when they open up, this may create problems if it leads to excessive haste. This applies to implementation as well as adoption: overly ambitious implementation timetables can lead to otherwise avoidable problems (*Poland: pensions; Germany: labour market*). Slippage with respect to implementation schedules may thus prove necessary at times, in order to avoid potentially costly implementation failures (*Mexico: pensions*). If haste is often a harbinger of failure, however, deliberation is by no means a guarantee of success (Figure 2.3). A number of thwarted reforms covered in the episodes were the focus of long and careful study and consultation processes, which in the end produced little or no reform (*Germany: retail hours; Netherlands: rent deregulation; Poland: farmers' social insurance; Mexico: labour law*). As expected, the rank correlation for preparation time across the 20 cases is highly significant; at the level of policy domains, it is also, albeit somewhat less, significant for pension reforms, but not for labour or product markets, reflecting long preparation and negotiation phases that precede adoption of most successful pension reforms.[58]

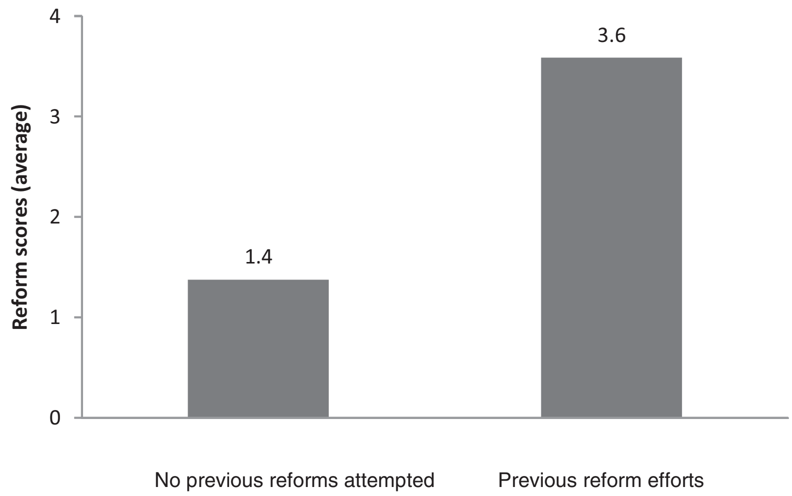
Figure 2.3. **Reform scores and speed of reform**



Policy regimes may be more or less "ripe" for reform

Reforming early, though desirable in principle, may be very difficult in practice. Successful reforms of established policy regimes are often preceded by an "erosion" of the *status quo*, involving (1) a widely shared conception that the policies and institutions in place are failing and (2) a series of incremental decisions that have already begun to weaken the existing policy regime.[59] While things need not reach crisis point, radical reforms often follow piecemeal changes to the old system that are found to be inadequate or even make things worse (*Poland: pensions; Germany: retail hours and Hartz; United States: welfare reform; Netherlands: disability insurance; Italy and Spain: labour market*).[60] Reform is likely to be more difficult where the existing arrangements are well institutionalised and popular, and where there appears to be no danger of imminent breakdown if reforms are not implemented (*Poland: farmers' social insurance; Sweden: sickness insurance*[61]*; United States: pensions; Mexico: labour law; Netherlands: rent deregulation*). In such circumstances, opponents of reform may not even need to present any alternative proposals of their own; they can simply defend the *status quo*.[62] The "reform ripeness" variable used in the rank correlations is thus defined in terms of previous reform attempts, even if these were partial, thwarted or reversed: successive attempts to reform a regime suggest a growing awareness of the need for change. The results suggest that reforms are indeed much more likely to advance where previous reforms have already been undertaken (Figure 2.4). "Ripeness" appears to be particularly important in respect of labour-market and pension reforms, whereas it has little impact on product-market reforms. This may reflect the fact that reforms of pension and labour-market institutions affect large parts of the electorate directly and alter arrangements which in some cases are seen as core welfare-state institutions. In the case of product-market reforms, it seems to be the broader policy context that matters, as was suggested by the policy interaction variables discussed above: a possible message may be that a government may well open up a sector at the first attempt, but that it is more likely to do so if it has been opening up other sectors as well.

Figure 2.4. **Reform scores and reform history**



The question of "reform ripeness" concerns not only the seriousness of the problem to be addressed but also the extent of awareness of the costs of the *status quo* and of agreement on the need for change – it is a question of communication (see below), as well as economic analysis, and is therefore to some extent endogenous to the reform process. The conclusion to be drawn, therefore, is not that reformers should leave "unripe" policy regimes alone, but that persuading stakeholders and the public of the costs of non-reform may be the first challenge in such cases. Indeed, the Spearman rank correlations show a statistically significant positive link between "reform ripeness" and "communication of the costs of the *status quo*", apparently reflecting the degree to which even partial or unsuccessful reform attempts can focus attention on a problem. A further important implication of this argument concerning "ripeness for reform" is that blocked, reversed or very limited early reforms need not be seen as failures: they may play a role in undermining the *status quo* and setting the stage for a more successful attempt later on. All of the more successful pension and labour-market reforms examined in this study followed earlier setbacks and many less successful reform attempts in all three domains can now be seen to have helped set the stage for subsequent, sometimes far-reaching reform initiatives (*Australia: water; Sweden: sickness insurance; Italy: pensions; Germany: retail*).

It often makes sense to "take what you can get"…

A number of cases highlight the ways in which tackling the easiest issues first can generate a momentum for reform that facilitates further change.[63] The initial steps may create pressure for further reform by changing agents' expectations and/or activating new constituencies (*France, Poland, Mexico: pensions; Germany: retail; Sweden: sickness insurance and postal reform; Australia: electricity; Spain: labour market; Netherlands: disability insurance*). If early measures lead to an expectation of further reform, agents begin to adjust their behaviour in anticipation, and this itself may reduce resistance to subsequent measures.[64] Indeed, changed expectations and the activation of new interests are among the ways in which reform setbacks sometimes lay the basis for subsequent success (*Italy: pensions; Sweden: sickness insurance; Netherlands: disability insurance*). As the reform process unfolds, the privileges and rents retained by those untouched by the first reform measures may become ever more apparent and thus more difficult to defend. Hence, the typical pension reform sequence in many countries begins with (relatively less privileged) private-sector employees before moving to the main public sector scheme and then to the more specific schemes that exist in the most privileged parts of the public sector.[65] Likewise, as noted above, labour-market reform often begins with reforms that target labour-market outsiders and leave insiders protected – a classic "take what you can get" strategy.

In product markets, the process is somewhat more complicated, but broadly speaking, sectors that have already been opened up to competition (whether via international opening or the deregulation of domestic product markets) often support efficiency-enhancing reforms in the sectors on which they rely for inputs and services (*Australia: electricity; Sweden: postal reform*). The literature suggests that this is a relatively common pattern in the diffusion of product-market reforms, with sectors under competitive pressure gaining from reforms "upstream".[66] In the present study, it is noteworthy that such pressures were lacking in respect of the product-market reforms that were thwarted (*Germany and Spain: retail; Netherlands: rent deregulation; Australia: water*). In three instances, the regulated sectors were oriented towards households, so there were no "downstream sectors" to mobilise. Households in these cases either found reform unattractive (rent) or simply saw too little immediate benefit from reform for it to be electorally salient (retail). In the case of Australian water, market-oriented reforms threatened the interests of an irrigated agricultural sector which had grown up largely in response to past water policies.

… but such a strategy also has risks

A strategy focused on starting with "low-hanging fruit" has its pitfalls. First, if very modest initial proposals are seen as harbingers of deeper reforms to come, some agents may adopt an intransigent position in opposition to even relatively minor measures in order to forestall the risk that the process will subsequently go further (*Italy: labour market*[67]*; United States: pensions; Netherlands: rent deregulation*). Secondly, it can be difficult to ensure that the first wave of reform does indeed lead to further reform. The value of the rents enjoyed by exempt groups may *increase* as a result of reforms that target others, thus increasing the unreformed insiders' incentives to protect their privileges. The problem of deepening labour-market dualism illustrates how hard it is to move from flexibility at the margin to a reform of the "core" of the labour market.[68] This stands in contrast to the pension reform path described above. In all likelihood, the difference between the typical pension and labour-market reform sequences reflects the relative sizes of the unreformed groups. Pension reforms tend to begin with large but poorly organised and less privileged groups, before proceeding to address the various more privileged regimes. As reform proceeds, the unreformed minorities that remain are isolated and find it ever harder to defend their anomalous positions. In labour markets, the situation is often reversed: the initial outsider-oriented labour-market reforms typically target minorities, leaving the majority of workers untouched. The unreformed sector is thus larger than the reformed one.

Communication, consultation and leadership

There have long been debates about whether and when reformers should mask their intentions from the public ("reform by stealth") or, alternatively, maximise the transparency of the policy process in an effort to win stakeholder and public support for reform. The case studies point to the desirability of the latter strategy, not least in view of the importance of electoral mandates discussed above. In addition to facilitating reform adoption, such an approach can improve the quality of the reform design and reduce the likelihood that the reform will be reversed if the political conjuncture changes.[69] Effective communication, consultation and research can all contribute to a consensus for reforms; reform adoption may take longer when such an approach is employed, but the quality of policy is likely to be higher and subsequent reform reversals less common.

Effective communication and consultation efforts pay off

In the more successful episodes, governments made considerable efforts from an early stage to explain and sell the reforms to stakeholder interests and, in most cases, the public (*France, Italy,*[70] *Poland, Mexico: pensions; Germany*[71] *and Spain: labour market; Netherlands: disability insurance*). This process served not only to generate support for reform but also, in many instances, to enable the authorities to identify potential problems and, where necessary, to improve reform design in response to feedback from stakeholders. By contrast, communications strategies were weak in connection with some reforms that were blocked (*France: labour market; Italy: pensions;*[72] *Poland: farmers' social insurance*) or that provoked especially strong opposition (*Germany: labour market*[73]). Effective communication was closely related to government cohesion in many case studies, since divided governments tended to send out mixed messages (*France: labour market; Italy: pensions; United States: pensions; Netherlands: rent deregulation*). Targeting the right audiences was also important: in the case of the 1993 labour-market reform in France, the adoption phase of the reform involved extensive discussions with the unions, but the real problem was a failure to explain the *contrat d'insertion professionnelle* to the young people who would be most directly affected by it. A similar problem arose in Germany when the benefit reforms that accompanied Hartz IV were being implemented. In cases where proposed reforms were likely to have a very broad impact across society (*e.g.* reform of pensions and entitlements, labour contracts or rent regulation), effective communication and consultation seems to have been essential: unilateralism has not proved a promising strategy for pension reform, in particular.[74] By contrast, the case study evidence suggests that public communication efforts may be less important in respect of relatively technical or narrowly focused sectoral reforms (*Germany and Spain: retail; Sweden: postal reform; Australia: electricity*); in such cases, public understanding is unlikely to be decisive.

Communicating the goals of reform can be particularly important, since lack of clarity about objectives may increase uncertainty, allowing opponents of reform to (often misleadingly) define the likely endpoint of the process in the public mind (*Netherlands: rent deregulation; Australia: water; Germany: labour market*[75]). Clarity about objectives may also be an aid to reform design: where the aims of reform are not clear and coherent, it is difficult to ensure that the policies chosen will meet them: in several cases, the complexity of the reforms' objectives, which sometimes evolved in the course of the reform process, made it difficult to map the chosen instruments onto the desired outcomes (*France: labour market; Australia: water; Netherlands: rent deregulation*). Moreover, there is some evidence that better communications reduce the likelihood of reform reversals. Reforms imposed on the basis of *force majeure* conditions rather than intellectual persuasion may more easily be reversed once those conditions disappear.[76] The reversal of Swedish sickness insurance reforms in the 1990s illustrates this phenomenon, as does the blocking of Poland's reform of the farmers' social security system when fiscal pressures eased in 2004-05.

These conclusions stand in contrast to some of the arguments advanced in the literature on the political economy of reform, which hold that reformers should avoid declaring their intentions to the public *ex ante*, since this will mobilise opposition to reforms that are expected to be painful; instead, they should aim for speed and stealth, seeking to advance reforms before reform opponents can react.[77] On this view, governments should not be afraid to get ahead of public opinion; rather than feeling constrained by the need to create a social consensus, they should offer leadership, confident that a consensus will form in support of a successful reform.[78] As noted above, however, such strategies typically prevail when reforms are adopted in crisis conditions and when they bear fruit quickly. The only such episode in the present study concerns the fiscal crisis in the Australian state of Victoria, which played a key role in pushing market reform of the electricity sector forward. Yet even in Victoria, the government's early moves had to be ratified at a subsequent general election, since power-sector reform was too complex and time-consuming to impose rapidly and present to voters as a *fait accompli*.

Communicating the costs of non-*reform can be critical*

Opposition to reform is often based on arguments about the balance – and distribution – of costs and benefits of policy change.[79] It can be difficult to make a case for reform to the public, given that structural reforms often involve substantial up-front costs, with the benefits coming later.[80] Even in the absence of any uncertainty or conflict about the *allocation* of costs and benefits, rational agents may question the need for reform, given that they will discount the future. Moreover, the link between a reform and its benefits can be far more difficult to establish, even *ex post*, than the connection between a reform and its costs.[81] Distributional issues aside (these are addressed below), would-be reformers often face a challenge in simply persuading stakeholders and the public that the overall assessment of costs and benefits favours reform. The case study evidence suggests that this is largely because the costs of the *status quo* are often poorly understood. The depth of this challenge depends on the policy in question: since at least the early 1990s, it has become easier to convince the public of the need for – and, perhaps, the inevitability of – the reform of general pension systems (*France, Italy, Poland, Mexico: pensions*), even if the urgency of reform was sometimes questioned (*United States: pensions*). This reflects in no small measure the impact of public discussion of research on the implications of population ageing, in particular, for traditional public pension systems. Labour-market reform issues are less well understood – particularly the costs that high levels of EPL impose.[82] However, voters know when labour-market performance is poor, and the labour-market reform cases show evidence that reform progressed as the costs of the *status quo* came to be better understood (*Netherlands: disability insurance; United States: welfare reform; Germany*[83]*and Spain: labour market*). Reform was more difficult where these were not appreciated (*France: labour market; Sweden: sickness insurance; Mexico: labour law*). Indeed, the Spearman correlations confirm the importance of this factor, especially in respect of labour-market reforms (Table 1.2). By contrast, it was far more difficult to communicate the costs of the *status quo* in respect of product-market reforms (*Netherlands: rent deregulation;*

Australia: water; Spain and Germany: retail; Sweden: postal reform), in large part because these were often opportunity costs and therefore "politically invisible".

The major exception to this rule – the Australian electricity reform – was characterised by a determined effort to quantify the costs of the *status quo* and the potential benefits of reform and to communicate these to stakeholders and the public.[84] Comprehensive and transparent explanations of the short- and long-run costs and benefits of reform, underpinned by solid research, can be crucial elements of successful structural reforms. This is particularly important when the costs of the existing regime are opportunity costs. Often, it is fairly clear who will pay the price for a reform – which firms are likely to come under pressure and which jobs may be at risk – whereas it is not at all obvious who is paying for the *status quo*: it is difficult to identify firms that have never entered the market, sectors that have not developed or the workers whom they would have employed. Effective communication of the costs of *non*-reform can thus contribute to making a policy regime ripe for reform. It is also closely linked to a government's attempt to win a popular mandate for reform: the rank correlations suggest that these two variables are closely and significantly related in the case studies. Effective communication of the implications of non-reform can also change the "reference case" that agents use when evaluating their options. One reason it can be difficult to identify potential "winners" from a reform is that people tend to evaluate their expected pay-offs under reform against the *status quo*. Where the existing policy is unsustainable (*France, Italy, Poland, Mexico: pensions; Australia: water*), it is critical that agents assess their position under a future reform against an *unreformed future* rather than the *status quo ante*.

Although good research is no "fix" for politics, it helps

The quality of the analysis underlying a reform can affect prospects for both adoption and implementation, as well as the quality of the policy itself. Of course, it is clear from both the case studies and the wider literature on the role of economic analysis in policy making that the political context will influence the reception of any particular line of analysis by the public or policy elites at any given moment: politically unwelcome research findings may at first be challenged or simply rejected by powerful institutions and interest groups.[85] However, the evidence suggests that the influence of policy-oriented research, however diffuse and indirect, can be quite powerful over time, as it gradually reshapes the consensus concerning a policy regime. In the case studies, this is clearest in respect of reforms that were debated over a relatively long period (*United States: welfare reform; Australia: water and electricity; Netherlands: disability insurance; Sweden: sickness insurance*). The reception of economic analysis also depends on the source: research presented by an authoritative, non-partisan institution that commands trust across the political spectrum can have a far greater impact. Building such institutions can take time, as their effectiveness depends greatly on their reputation, which may take a considerable period to establish, but they can in the long run make a significant contribution to the quality of both policy making and public debate.

It is in this context that international institutions can have a role to play. The evidence of the case studies concerning the influence of the OECD, in particular, is generally consistent with the findings of other research in this area.[86] There is little evidence of a direct impact of OECD advice on policy making in the case studies. This is not surprising, given that most OECD recommendations are neither binding on member states nor backed up by financial or other incentives. The evidence does suggest, however, that the case for reform is strengthened by the availability of internationally comparable data and analysis. Often OECD influence was mediated via domestic institutions, such as the CPB Netherlands Bureau for Economic Policy Analysis, the Australian Productivity Commission or the various economic think-tanks in Germany.[87] These bodies also feed their own research and analyses into policy debates and, indeed, into the work of international institutions. In the early 1990s, the OECD *Jobs Strategy*, for example, did become a point of reference in labour-market reform debates in some countries.[88] While OECD recommendations and data were cited rather frequently in some debates, the clearest impact of OECD work was observed when countries were able to see their performance or policy regimes in comparative context: benchmarking often signals to electorates or elites that institutions or situations that they may have come to regard as normal may in fact be quite unusual by international standards.[89] Finally, Armingeon (2004) highlights the role of the OECD in creating and sustaining "epistemic communities" – transnational networks of experts who then influence policy debates within their respective countries by framing both policy problems and potential solutions for decision-makers.[90]

Major reforms may benefit from institutions that foster consensus

A number of the case studies point to the potential utility of credible "reform institutions", like Australia's Productivity Commission or the Dutch CPB. More specialised bodies like the French *Conseil d'orientation des retraites* or Poland's Office of the Government Plenipotentiary for Social Security Reform (BPR) can play a key role in specific domains.[91] Such institutions can serve as fora for study and negotiation and help to "de-politicise" sensitive reform issues (this is particularly common in the case of pension reform, because it directly affects virtually the whole population). Even if they do not actually design the reforms or resolve distributional conflicts, they can – if they are seen to be credible and reasonably impartial – make progress easier by fostering consensus on certain basic issues, including the costs and benefits of both the *status quo* and reform (*France and Poland: pensions; Germany: labour market; Netherlands: disability insurance; Australia: electricity and water*).[92] They can also improve the quality of policy making, by providing research and analysis to inform the process, as well as a forum in which issues can be debated openly and research findings scrutinised.[93] Although member countries may rely at different times on both permanent bodies and special commissions and committees, the case studies suggest that such institutions may carry more weight if they are permanent, independent public bodies rather than *ad hoc* commissions or working groups.[94] The latter can have a significant impact but tend to disband soon after they report their findings. Moreover, permanent "reform institutions" with a fairly broad remit may be less susceptible to capture by specific interests than those that are specialised in very specific areas. Whether permanent or *ad hoc*, such bodies must be seen as impartial: if they are highly politicised or seen as an attempt to circumvent key actors in the policy process, they may actually *intensify* opposition to reform, since they will not be seen as impartial (*United States: pensions; Mexico: labour law*). Germany's Hartz Commission was arguably something of an exception to this rule, but it was formed when the traditional participants in labour-market policy consultations had been weakened by a scandal at the Federal Labour Office. Moreover, after the Hartz report was issued, the relevant legislation went through "normal" consultative policy processes.

It is striking that in the Australian and Dutch cases, the key reform institutions were deeply involved in the more successful reforms (electricity and disability insurance, respectively) but played a limited role in the less successful episodes (water and rent deregulation). Since then, the Productivity Commission has done much more work on water, and the CPB and other bodies in the Netherlands on housing, as governments in those countries have sought to renew reform processes in those areas.[95] Research in many instances initially tends to follow rather than lead early policy reform debates.[96] Thus, early reforms to a regime are often undertaken with little basis in research, but they then trigger a large body of subsequent research that begins to shape the debate over subsequent steps (*Sweden: sickness insurance; Australia: water; Netherlands: rent deregulation; United States: welfare reform).*

Research capacity and reform institutions can help provide needed feedback and adjustment

A successful reform need not be perfect, particularly when governments are engaged in policy innovation and the reform is at or near the international frontier. As is clear from many of the case studies, reform often requires "learning by doing", so it makes sense to design mechanisms for *ex post* assessment of outcomes; adequate feedback and adjustment can be critical.[97] This can be done in a variety of ways, but strong analytical and research capacities generally need to be part of the process; new institutions created with a mandate to implement and develop a reform, like the Swedish postal regulator or the various institutions created to run the Australian electricity market, may also play an important role in reacting to implementation surprises and making needed adjustments as the reform unfolds.

Government cohesion is of crucial importance

Perhaps the strongest single finding to emerge from the case studies concerns the unity of the government. In almost all cases in which there was public conflict within the government or the governing party over a reform, the reform was ultimately thwarted (*France: labour market; Italy: pensions; Germany: retail;*[98] *Poland: farmers' social insurance; United States: pensions;*[99] *Sweden: sickness insurance; Netherlands: rent deregulation; Spain: retail regulation*[100]). This held true across all three policy domains under study but it was especially strong in respect of labour-market and pension reforms (Table 1.2). There were only two exceptions to this rule among the 20 cases examined: in Italy, public differences within the governing coalition weakened the government's position *vis-à-vis* opponents of the Biagi labour-market reform law but did not prevent its adoption, and the PRWORA welfare reform in the United States emerged as a compromise negotiated between a Republican congressional majority and a Democratic White House, over the objections of many of the administration's own welfare policy makers. However, the US case is highly peculiar: both parties were committed to a reform reflecting certain basic principles, and the splits in the administration arose in the context of negotiation over how those principles were to be applied rather than a conflict between proponents and opponents of reform. Other studies also suggest that government cohesion comes close to being a necessary – though by no means sufficient – condition for successful reform.[101]

When governments are seen to be less than united, opponents of reform are quick to exploit the situation, whether that disunity reflects conflicts within the government unrelated to the reform – *e.g.* rivalry among parties in coalition – or differences within the government over the reform proposal itself. At times, lack of unity can also contribute to the incoherence of the measures proposed, as compromises adopted to appease various stakeholders within the government camp complicate the reform (*France: labour market; Netherlands: rent deregulation*). The rank correlations confirm that government cohesion is not unrelated to the question of electoral mandates and the effectiveness of the government's communication efforts.[102] Logically, it should be easier to keep a government united in support of a reform it has already promised to the voters, and in the cases under review, none of the governments that were publicly divided over reform could credibly claim an electoral mandate for the measures they were proposing.[103] Likewise, if the government is publicly split over policy, it is bound to send out mixed messages to voters and other stakeholders.

"Ownership" of reforms is also important

As the foregoing discussion of government cohesion and clarity implies, clear "ownership" of reform initiatives can be important. This is one of the hypotheses finding strongest support in the case studies. Many of the more successful reforms under study were driven by clearly identifiable individuals or institutions prepared to take ownership of them and having an interest in seeing them succeed (*France, Italy, Poland, Mexico: pensions; Italy, Germany: labour market; Netherlands: disability insurance; Sweden: postal reform*). By contrast, reforms were less likely to be pursued where such leadership was lacking (*France: labour market; Mexico: labour law;*[104] *Germany: retail hours; Spain: retail regulation*). Reform "orphans" rarely succeed. This is true even after the initial adoption of a reform: sustaining reforms can be difficult if the policy entrepreneurs who pushed them forward leave the political arena before they are consolidated (*Germany: labour market*). There is, of course, a risk of *ex post* bias here: there will be plenty of actors ready to claim credit for a successful reform, while agents involved in the policy process will try to disown failed initiatives. In the cases cited above, however, the evidence is fairly strong that the presence or absence of clear ownership was apparent *ex ante*. This observation is very much in line with other research highlighting the importance of leadership from executives with a strong commitment to reform and a readiness to take risks.[105] Yet the presence of such leadership is not simply a question of personality or good political luck: "policy entrepreneurs" do sometimes emerge independently of any government strategy or commitment,[106] but they are more often "made" by governments, *e.g.* by the designation of ministers, officials or institutions with clear mandates to promote specific reforms. Even energetic entrepreneurs may find their initiatives blocked, however (*Poland: farmers' social insurance; United States: pensions; Netherlands: rent deregulation*).

Dealing with actual or potential opponents of reform

Even if there is a clear consensus that a reform will generate net benefits for the economy as a whole, questions concerning the allocation of costs and benefits are often unavoidable, owing to differences in agents' interests and endowments,[107] the presence in many situations of potential "stranded assets",[108] and uncertainty about individual benefits.[109] Often, the costs of reform are not only incurred up-front, they are also concentrated on specific groups, whereas the benefits not only materialise later but are also both more diffuse and less predictably allocated.[110] The literature on structural reform devotes a great deal of attention to the question of when and how those who lose out as a result of reform might be compensated, whether by exempting them from the reform, at least for some period, or via some sort of alternative compensation. Failure to compensate may reinforce opposition to reform, but excessive compensation may be costly or may simply blunt the effects of the reform itself.[111] In a repeated game it may also reinforce opposition to future reforms. The most common compensation strategies involve "grandfathering" rents and long transition periods, both of which are discussed below. Concessions in the form of "side payments", such as adopting policies in other domains that might offset the cost of reform for some groups, were rarely important, although the Spanish labour-market episode was an exception.[112] In return for accepting some reduction of EPL for regular workers, the trade unions in 1997 secured changes to the system of collective bargaining that they wanted; while these changes had less impact than anticipated, the political exchange involved was an important part of the overall reform bargain.

Concertation can be useful but is no substitute for government leadership

Progress may sometimes be facilitated by intensive discussions involving the government and the social partners in a highly formalised process (*Italy: pensions*[113] *and labour market; France: pensions; Poland: pensions; Germany*[114] *and Spain*[115]*: labour market; Netherlands: disability insurance*). However, firmness of purpose on the part of the government also seems to be a critical element of success in such situations. The rank correlations suggest that government leadership – as proxied by an assessment of evidence of the government's readiness (or lack thereof) to act unilaterally or to sanction non-co-operation on the part of the social partners – is particularly important in respect of labour- and product-market reforms (Table 1.2).[116] Consultation need not mean allowing stakeholders to be veto players, and several cases suggest that a "concertationist" approach is unlikely to succeed unless the government is in a position to reward (sanction) co-operation (non-co-operation) by the social partners or can make a credible threat to proceed unilaterally if concertation fails (*Italy, Mexico, Germany*[117] *and Spain: labour markets; Italy: pensions*). Where the government is too weak to lead or is unwilling to do so, the social partners have little incentive to make concessions.[118] By contrast, corporatist arrangements can work well where the government is prepared to lead. They can be particularly important when negotiating reforms to core welfare-state institutions, which may call into question explicit or implicit social pacts that are regarded by important segments of society as fundamental features of the social order.[119]

In several of the cases under examination, governments paid a price for eschewing concertation in respect of reforms that the social partners believed should properly be the subject of social bargaining (*Italy: pensions and labour market*[120]*; Spain: labour market; Poland: farmers' social security*). Concertationist practices, though sometimes very useful, may lead the agents to conclude that sensitive reforms *must* be the subject of corporatist bargaining, so that any attempt at reform outside such a framework will meet resistance on procedural as well as substantive grounds: even fairly modest reforms may meet stiff opposition if they are perceived as being "imposed". There is some reason to think that such "unilateral" reforms are more likely to be reversed than those negotiated with the social partners.[121] This can have implications for implementation, since the perception that a reform is likely to be reversed reduces individuals' incentives to adapt to the new conditions, and those threatened by a reform may opt to resist implementation in the hope that the *status quo ante* will soon be restored. Moreover, while a unilateral approach may enable the government to adopt bolder reforms than the social partners would accept, the social partners' active co-operation may still be required for effective implementation. The degree to which stakeholder co-operation is needed for implementation of a reform – or to achieve progress on other reforms – may thus be a factor in determining whether and to what extent the government should accept the constraints of corporatist bargaining when trying to win adoption of reforms. The other factor that must be borne in mind is that concertation may distort the content of reforms, since the parties represented at the table with the government represent specific segments of society. Employers' bodies represent incumbent firms (and, in many cases, they are more representative of some segments of the population of firms than others), while unions tend to be most representative of older cohorts of industrial workers. This leaves the burden of representing "outsiders" very much on the government.

Involving potential opponents in the post-reform system may facilitate adoption of reforms – but at a price

Where particular opponents of reform are positioned as *de facto* "veto players", capable of blocking its adoption or impeding its implementation, it may be possible to win their assent by giving them a role in the new system. Successful pension reforms, in particular, frequently offer opportunities for trade unions in the reformed system, for example in the administration or running of pension funds (*France, Italy,*[122] *Poland and Mexico: pensions*).[123] It is less common in respect of labour-market reforms (Table 1.2), though here, too, it may play a role (*Italy, Germany and Spain*[124]*: labour market*). However, this strategy has its risks: it may limit the scope of the reforms that can be adopted and it means that implementation of important elements of the reform may need to rely on the co-operation of parties who are not fully committed to it.

Acquired rights are typically "grandfathered"

Where acquired rights are concerned (particularly pension or benefit entitlements), large groups may need to be wholly or partially exempted from the reform in order to secure its adoption. Thus, current pensioners are rarely affected by pension reforms and older cohorts of workers usually experience only minimal change (*France, Italy,*[125] *Poland, Mexico and United States: pensions*).[126] In both Italy and France, the transition periods for pension reforms were long enough to ensure that the bulk of the voting age population when the reforms were adopted would escape their full effects.[127] This reflects in part the fact that trade unions and political parties tend to be oriented towards the interests of older cohorts, but there are also good economic arguments for significant transition periods when it comes to pension reform. Sharp swings in pension policy can be costly to contributors making career/savings choices that will pay off only in the long term. The microeconomic benefits of pension reform depend in part on the clarity and stability of the link between contributions and benefits.[128] The costs of pension reform thus tend to be borne chiefly by younger cohorts. Since it is they who will lose out if the system proves unsustainable over the long term and since they have longer to adjust their private arrangements for financing retirement, this tends to be politically acceptable.[129] Indeed, the lack of overt inter-generational conflict is one of the most striking features of the politics of pension reform: there is no evidence of it in any of the case studies, and recent academic work on the political economy of pension reform in a large number of countries finds little evidence of it elsewhere.[130]

In respect of labour-market reforms, too, large numbers of incumbent regular employees may also be effectively exempted, *e.g.*, by limiting reforms to new contracts or specific types of employment relationship (*Italy, Germany and Spain: labour market; Netherlands: disability insurance*). The problem of acquired rights is most straightforward where labour contracts are concerned. It is less clear when unemployment or other benefits are being reformed, since the question of whether existing contributors or beneficiaries in the system really have some sort of "acquired rights" that must be respected depends on how the system is organised and conceptualised.[131] Thus, some benefit reforms directly affected the position of those already on benefit (*United States: welfare reform; Sweden: sickness insurance*), while in other episodes, benefit recipients were shielded from at least some of the changes (*Germany: labour market; Netherlands: disability insurance*). This reflects not only the way social insurances are organised but also the organisational and other resources of the groups that stand to lose.

Product-market rents are usually phased out gradually

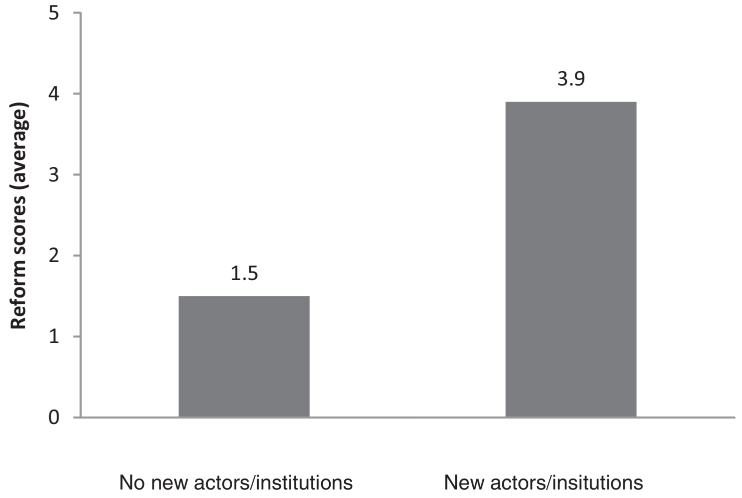
Compensation in the form of exemptions and "grandfather" clauses is likely to be more difficult in cases of market opening, since grandfathering rents (*i.e.* exempting incumbents indefinitely) may risk worsening rather than alleviating market distortions, if the result is that new entrants and incumbents are subject to different rules.[132] Thus, the product-market reforms examined in this study typically applied to incumbents as well as new entrants but included transition arrangements designed to ensure that the producer or consumer interests affected did not experience abrupt changes in economic conditions (*Spain: retail; Australia: electricity and water; Sweden: postal reform; Netherlands: rent deregulation*). In some cases, such arrangements were insufficient to allay opposition to the reform. The most difficult problems tend to be those that arise when the rents resulting from anti-competitive regulatory policies are capitalised into the prices of assets.[133] In the two retail cases, for example, investments undertaken on the basis of past policies would have earned lower returns, or even become unprofitable, in the event of reform. The Australian water episode highlighted a related but distinct problem – that of "stranded assets": water reform threatened to make it impossible to earn an economic return on many investments in rural areas, particularly in irrigated agriculture. These investments had been made on the basis of the previous policy regime, which had strongly encouraged irrigation-based development and rural settlement.[134] More generally, employer-employee relationships usually involve some element of relationship-specific investment that is lost when reform leads to a separation, so "stranded assets" problems can affect labour as well.

Long transitions pose their own risks

If the adoption of reform is made easier by introducing long transition periods and/or postponing resolution of some contentious issues or exempting certain groups, then mechanisms need to be put in place to ensure that the reform is completed. One way to do this is to introduce a degree of automaticity into the policy process, *e.g.*, by providing for more or less automatic actuarial adjustments in pension systems (*France and Italy: pensions*) or by defining specific procedures and deadlines in the original legislation for handling reform-related issues still to be resolved (*Poland: pensions*). The government may also delegate authority to resolve some contentious issues to independent regulators or institutions with special expertise (*Sweden: postal reform; Australia: electricity*). Both these devices can have the effect of shifting responsibility for sensitive decisions from politicians to relatively apolitical bodies, a form of political pressure deflection that policy makers may find attractive.[135] However, it is important that legislative provisions mandating future actions be credible and that independent regulators be strong enough and independent enough to pursue their mandates effectively; otherwise, issues deferred at the adoption stage may be postponed again and again, as lobbies mobilise in an effort to thwart full implementation of the reform (*Poland: pensions; Italy: pensions and labour market*). Sustaining the momentum of reform through a lengthy transition may be easier if the initial stages of the reform give rise to the creation of new institutions or the emergence of new actors who will have an interest in pressing for further reforms later on (*Sweden: postal reform; Australia: electricity and water; Poland and Mexico: pensions;*

Italy[136]*, Germany and Spain: labour market;* Figure 2.5). It should also be easier where reforms are adopted on the basis of a fairly broad consensus.

Figure 2.5. **Reform scores and the emergence of new actors**



Tactical concessions to potential losers need not compromise the reform

Concessions are sometimes made to opponents of reform in order to secure their involvement or at least their acquiescence. Such concessions may contradict the logic of the reform, rendering it less coherent overall, usually by creating too many exemptions and exceptions to the reform (*France and Germany*[137]*: labour market; Poland: pensions*[138]). However, it is important to recognise that concessions to potential losers need not contradict the overall thrust of the reform. Some concessions may actually be coherent with it. These can take the form of offering potential opponents a role in the new regime or agreeing transition arrangements that protect vulnerable groups (*France, Poland, Mexico: pensions; Spain: labour market*). They may also take the form of explicit "sunset clauses" that provide for a review of the new arrangements at the end of a certain period (*Spain: labour market*). While commitment to such a review means that there may be a later opportunity for opponents to try to reverse the reform, it may be needed to make adoption possible and, if the reform is generating positive results, an evidence-based *ex post* review can help to consolidate it.

Potential losers are more likely to mobilise than winners

There is remarkably little evidence in the case studies of the active mobilisation of interest coalitions in *support* of reform, except in the case of some product-market reforms:

- Where pension reform is concerned, reform is usually about retrenchment: younger workers may in future have a lighter tax burden than without a reform, but they will also have less generous pension schemes. The system as a whole may be put on a sustainable footing, but individual workers are unlikely to feel like winners if they compare their post-reform pension rights with their pre-reform entitlements, rather than with the losses they would suffer if an unsustainable *status quo* were not reformed in time to prevent a crisis. More striking is the lack of mobilisation by financial-sector interests in support of funded pension plans, except in Poland. However, it is not clear that activism on their part would have been helpful elsewhere (*Mexico and United States: pensions*), given opponents' claims that reforms were intended to benefit financial interests at the expense of future pensioners.

- In the case of labour-market reforms, the potential winners are often labour-market outsiders – the unemployed or very precariously employed (or even those outside the labour force altogether) – whereas those threatened by reform tend to include workers on permanent contracts (*Italy: labour market; Mexico: labour law*). Outsiders are not as well organised or as influential as insiders. In other instances, the potential "beneficiaries" of reform may not have welcomed it: reforms aimed at activating those who would otherwise be on benefit might increase incomes for some in the end, but pressure on benefits would still be resented, particularly by those seeking a transition to early retirement (*Germany: labour market; United States: pensions; Sweden: sickness insurance; Netherlands: disability insurance*).
- Potential beneficiaries were much more active in support of product-market reforms (*Germany and Spain: retail; Australia: electricity; Sweden: postal reform; Netherlands: rent deregulation*). Water reform in Australia proved an exception to this generalisation; however, this seems to have been because there were far fewer obvious near-term winners than losers[139] – the key question was how the costs of the transition to a sustainable policy regime would be allocated – and thus no strong private-sector lobby in favour.

The hypothesis that losers are more inclined to mobilise than winners sits well with much of the literature. This is precisely what would be expected if the costs of reform were up-front and relatively concentrated, while the benefits were longer-term and more diffuse – and, indeed, if the allocation of benefits were uncertain. Moreover, the losers will in many cases be more politically powerful than the winners. As beneficiaries of the *status quo* they will often, though not always, dispose of greater organisational, political and financial resources. Older cohorts are generally more influential than the young when it comes to pension reforms, and labour-market insiders are easier to mobilise than outsiders in most circumstances.[140] Even in product markets, incumbents will more often than not have the edge on potential entrants. The literature on endowment effects and loss aversion suggests that, even given equal resources and similar positions, potential losers will be quicker to mobilise in order to resist losses than winners hoping to realise gains.[141]

In most of the cases under study, organised labour viewed reform proposals with suspicion, at least initially. While trade unions did in the end play a role in designing and implementing a number of major reforms examined here, they more often constituted a significant – though by no means the only – source of active opposition to reform. This reflects at least two factors. First, two of the three policy domains under study – pensions and labour-market policies – are particularly sensitive to trade unions. In most OECD countries, unions tend to represent older cohorts of incumbent regular workers, and in many, they also represent large numbers of pensioners.[142] In some of the product-market cases, moreover, unions were also engaged, because the rents generated by existing regulatory regimes were shared with labour. Secondly, owners of capital are, *ceteris paribus*, able to adapt to reform more easily than other agents, except perhaps in cases where reform risks leaving them with stranded investments. They can adjust their portfolios in response to policy changes and thus reap at least some portion of the benefits of a growth-enhancing reform. They are also better able to cope with the costs of *non*-reform in many situations, having recourse to a wider range of adaptive strategies in response to sub-optimal policies and institutions.[143] This puts them at an advantage in any conflict about how the costs of reform will be allocated.[144] Moreover, this is likely to matter more where the distributional consequences of reform depend on the specific measures adopted and are relatively easy to anticipate – *e.g.*, in connection with labour market reforms and pension reforms rather than, for example, financial or trade liberalisation.[145] Thus, while unions' opposition to reforms is sometimes presented by critics as ideologically motivated obstructionism, labour leaders often have reasonable grounds for worrying about the impact of reforms on their constituents.

In addition to casting light on the unions' attitude to reforms, this last point suggests a further reason why business interests, whose role in most of the episodes was weak or ambiguous, rarely seemed to mobilise in support of reforms that, at first glance, would appear to have offered them benefits (*Mexico and United States: pensions*). In a number of the episodes, employers had already devised strategies for dealing with the *status quo*, which, though sometimes costly, reduced their interest in reform, particularly where support for structural reform might aggravate relations with the unions and thus make collective bargaining more difficult (*Mexico: labour law; Spain: labour market; Sweden: sickness insurance*).

Relatively modest institutional changes can help strengthen the reform coalition

As noted above, creating "early winners" or new actors and institutions in the course of a reform can help to sustain the momentum behind it. It is sometimes possible to foster the emergence of private-sector constituencies with an interest in sustaining the reform, such as the private pension fund industry in Poland, but it may well be easier to affect the balance of interests by creating new public-sector bodies, like the pensions regulator in Poland or the various regulators created in the Australian and Swedish product-market reforms, or by restructuring institutions that already exist. A number of cases highlight the potential for relatively limited institutional changes to affect prospects for structural reform. Where inter-ministerial conflict is an issue, reconfiguring the institutions involved in shaping a given policy may help break the impasse (*Germany: retail and labour market; Poland: pensions*). Others point to the degree to which fairly modest changes in administration and financing of social insurance schemes can alter the incentives facing the non-state actors involved (*Sweden: sickness insurance; Netherlands: disability insurance*). Such moves may not directly resolve the problems that give rise to the need for reform, but they may well make it easier to tackle that problem via subsequent, more significant changes.

Can reforming governments win re-election?

There is a widespread belief among policy makers that voters will punish bold reforms, and this has been cited as a major reason why progress in reforming labour markets, product markets and social insurances has sometimes been very slow. The empirical evidence casts doubt on this expectation: other things being equal, reforming governments do not appear to face particular difficulty in winning re-election.[146] The present study, because it looks only at reform attempts actually undertaken, rather than at the propensity of governments to attempt reforms, cannot address this question directly. However, the likelihood of subsequent re-election was little different between the more and less successful reform episodes, and the re-election rates for all governments in the study was close to the average for all governments at all national elections in the ten countries covered during 1992-2008 inclusive.[147] While the number of cases involved is too small to permit generalisation, it is also worth noting that four of the five governments that successfully adopted and implemented reforms for which they had clear electoral mandates subsequently went on to win re-election. The cases studied here thus cast some doubt on the oft-repeated claim that good economics is necessarily bad politics.

Notes

1. For the sake of brevity, cases are referenced in the text with minimal explanation or elaboration. Since many of the episodes cover extended periods and discuss more than one policy process, individual cases may sometimes be referenced in ways that point to contrasting lessons. Where this is the case, endnotes are used to provide clarification.
2. Let alone the "manual for technopols" described by Williamson (1994).
3. Boeri *et al*. (2006) likewise emphasise the importance of such conditions.
4. It is important to note that this hypothesis concerns action following election *or re-election*: the case studies do not support the so-called "honeymoon hypothesis", according to which *new governments* are more likely to advance reforms successfully. Williamson and Haggard (1994) find little support for this view, which is also contradicted by the results obtained by Høj *et al.* (2006). Governments often need to find a suitable opportunity to advance reforms, but such opportunities may not always occur early in the life of a new government.
5. The Biagi law.
6. The Mexican labour-law case is somewhat peculiar, in that the reform agenda endorsed by the president during the election campaign was not that which the administration pursued in office.
7. The one clear case of reform *reversal* following such a policy shift (a "defection" from populist promises to reformist policies) was also the only one in which there was not a widespread sense that the economy was in crisis at the time the reforms were initiated; see Williamson and Haggard (1994:584-86).
8. In Spain and Germany, for example, both major parties were divided over retail regulation; in Australia, the same was true of electricity reform. Boeri *et al*. (2006) suggest that conflicts over product-market reforms often involve interest configurations that do not reflect the structure of partisan competition.
9. The United States is a special case: with national elections every two years, virtually all reforms are undertaken soon after elections – but they are also inevitably adopted in "pre-election" periods. Separation of powers also complicates the picture: PRWORA was adopted towards the end of the Clinton Administration's first term, but it was taken up by a new Republican majority in Congress almost immediately after it won control of the legislature. The Australian cases are also difficult to assess in terms of the electoral cycles, because both involve not only Commonwealth but

also state governments, whose electoral cycles are not synchronised with one another.

10. Since the present study includes one more successful and one less successful case per country, it is by definition impossible to draw conclusions about the impact of different voting systems. IMF (2004) finds that majoritarian systems are associated with more reform; Boeri *et al.* (2006) challenge this view, however, and Persson (2003) suggests that more proportional voting systems may favour more gradual reform than majoritarian systems but with a lower risk of reversal. Høj *et al*. (2006) examine the potential effects of proportional majoritarian systems and find them to be insignificant in both aggregate and individual policy regressions.

11. Divisions within the governing majority appear to have been related at least partly to manoeuvring ahead of the 1995 presidential election campaign.

12. In all of the more successful cases, reforms were undertaken shortly after an election and adopted relatively swiftly. The initial reform of Swedish sickness insurance, by contrast, was undertaken at the end of a parliament, and the long reform-design process in Mexico meant that two competing proposals reached Congress in the run-up to the 2003 elections. It should be noted, however, that France's CIP was initiated and blocked within the first year of the parliamentary term.

13. The 1994 pension reform attempt in Italy and the US Social Security reform debate of 2005 were the exceptions to this rule. The 1995 Dini reform in Italy passed with the backing of the centre-left parties that supported the Dini government, but only the far left and far right actually voted against it; the main centre-right parties (Forza Italia and the Christian Democratic Centre) abstained.

14. IMF (2004:116) finds that the proximity of elections can indeed hamper reforms, but Duval and Elmeskov (2005) report that their election-year dummy variable is insignificant; lags and leads of the dummy were found to be insignificant in the same specification.

15. In the US case, the two parties were effectively competing to claim credit for what was expected to be a generally popular reform and to demonstrate that they had made good on past campaign promises.

16. For more on the incentive for outgoing incumbents to adopt reforms aimed at binding their successors, see Goodman (1991), Cukierman (1994) and Tompson (1998).

17. Specifically, the first wave of radical reform in Victoria, following the 1992 elections.

18. The Biagi law.

19. See Boeri *et al.* (2006); and Williamson and Haggard (1994).

20. These results are consistent with the conclusions drawn by Høj *et al*. (2006), who find the size of the government's parliamentary majority to be insignificant in both aggregate and individual policy regressions, and by Boeri *et al.* (2006), who likewise find that seemingly "weak" governments do succeed in advancing reforms, though the strategies they adopt are naturally different.

21. The Australian product-market regulation episodes, of course, involved a number of state and Commonwealth governments of different partisan orientations.

22. Boeri *et al*. (2006).

23. Cukierman and Tommasi (1995).

24. Høj *et al*. (2006); IMF (2004).

25. It is possible that, in consequence, centre-left governments undertake more modest reforms than governments of the right. This would be consistent with the econometric evidence, but the cases presented here offer no basis on which to assess such a hypothesis.

26. It is nevertheless noteworthy that the 1994 reform in Spain and the Hartz reforms in Germany came at a time when relations between organised labour and centre-left governments were strained, not least owing to what the governments saw as union intransigence *vis-à-vis* needed reforms.

27. A final possible explanation for the apparent contrast between the case studies and the econometric results is that, in Europe at least, reforms of employment-protection legislation (EPL) seem to have been undertaken with roughly equal frequency by governments of the right and the left, but reform *reversals* in respect of EPL tend to be more common under the left. Saint-Paul (1996:284) concludes in respect of "two-tier" labour-market reforms that "there are about as many instances of the reform being achieved by a left-wing government as by a right-wing one." See also the data presented in Ochel (2008).

28. See Cukierman and Tommasi (1995, 1998); and Drazen (2000:430-1).

29. Constitutionally, Spain is not a federation, but it is one of the most decentralised countries in Europe, and the relationship between the central government and the country's 17 regions (*Comunidades Autónomas*) was critical to the debate over retail hours and entry. Mexico, by contrast, *is* a federal system, but both reforms included in the study concern federal policies, and the states played no significant role in these episodes.

30. The Spanish retail case study explores some of the reasons for the very different outcomes observed in the two countries.

31. Econometric studies are better for addressing this question than a case-study approach. These suggest that economic crises, protracted periods of slow growth and high unemployment are all important drivers of reform. See, in particular, IMF (2004), Duval and Elmeskov (2005) and Høj *et al*. (2006).

32. IMF (2004); OECD (2006).

33. See the Hartz reform case study for details.

34. See IMF (2004); Duval and Elmeskov (2005); Høj *et al*. (2006).

35. Poland is a special case: fiscal consolidation remained a priority during the period when the reform was first being prepared, but progress in shoring up public finances meant that the government could plan to use substantial future privatisation revenues to finance the one-off costs associated with structural pension reform rather than to plug holes in the current budget.

36. See Williamson and Haggard (1994); and Webb (1994).

37. There is a micro-level link as well as a macro-level relationship: individuals who feel themselves protected by EPL are less willing to pay for unemployment insurance than those who do not. The United States, however, is an exception, with low EPL and relatively limited UI.

38. See, in particular, Saint-Paul (1996, 1998); Elmeskov *et al*. (1998); Duval and Elmeskov (2005); Boeri *et al*. (2006); and Ochel (2008).

39. The PRWORA reform in the United States also focused on labour-market outsiders, but US unemployment was already well below its cyclical peak and EPL in the US is in any case far lower than in much of OECD Europe.

40. In a study of EPL reforms in 16 European countries covering 1990-2003, Ochel (2008) reports a reduction in EPL for regular workers at a time of rising unemployment in only one other instance – Finland in 1990-91. See also the data in Høj *et al*. (2006:38), which shows Spain to be the OECD member recording by far the largest reduction in EPL for permanent workers during 1985-2003; indeed, the OECD average score on this indicator was roughly unchanged over the period.

41. On the unique position of Spain in this respect, see Ochel (2008): exceptions to the "two-tier reform" pattern remain extremely rare.

42. In other words, the median voter was arguably a labour market outsider; Bentolila *et al*. (2008).

43. IMF (2004); Duval and Elmeskov (2005); and Høj *et al*. (2006).

44. Cross-border shopping was a significant concern for many German *Länder* prior to the reform of the *Ladenschlussgesetz*.

45. The most significant exception is the Italian case, where many of the reforms of the early-to-mid 1990s stemmed from the social pacts agreed in 1992-93.

46. The OECD composite indicator for product-market regulation began falling fairly rapidly in 1990, and this rapid decline continued through 1996, with a somewhat gentler downward slope thereafter.

47. The coefficient for policy interactions within the pension reform domain is also significant, but, as explained in Annex 1.A1, the relationship between the pension policy indicator and pension reform outcomes should be viewed with caution. The product-market indicator measures changes in seven sectors around the time of the reform and is therefore unlikely to be driven solely by the reforms under study. It is thus a far more reliable indicator of the broader policy context.

48. In the case of postal reform, the action-forcing event was CityMail's entry. After a long period of study and discussion, the government had to decide whether to uphold *Postverket*'s monopoly or not.

49. On the link between crisis and reform, see *inter alia*, Williamson (1994); Rodrik (1996); Elmeskov *et al*. (1998); Drazen (2000); IMF (2004); Duval and Elmeskov (2005); Høj *et al*. (2006); and Boeri *et al*. (2006).

50. While there is little doubt about the link between the crisis of 1992 and the labour-market reforms that followed later in the decade, as the July 1993 pact was implemented, the crisis did not force immediate labour-market reform. Rather, it set in train political changes that created a new opening for reform.

51. The end of PRI rule shook up many established interest coalitions in the early 2000s, lending a fluidity to government-union relations, in particular, that opened up opportunities for reform.

52. The fiscal crisis in Victoria was indeed an action-forcing event, but it did not compel the Victorian government of the day to opt for power-sector restructuring as part of its fiscal package; the government rather saw the crisis as an opportunity to press ahead with a reform that was considered desirable for other reasons.

53. There are good grounds for believing that the adjustment costs are higher when reforms are undertaken in response to crisis, though this depends to some degree on the nature of the crisis. See IMF (2004).

54. It is necessary to acknowledge, however, that the 1992 Amato pension reform in Italy was also born in the midst of a crisis. Though this reform stuck, some of the cuts it contained were restored when the implementation decrees were issued by the Ciampi government in 1993.

55. Such "pre-work" takes a variety of forms, from research and analysis by independent institutes or government bodies to inquiries by official commissions or committees of inquiry. What is crucial is that officials and policy makers seeking to design a reform have access to a pre-existing body of good-quality research on which to draw. See Cole (2007).

56. The initial 1991 reform package was adopted with little preparation in the midst of an intense crisis.

57. Some recent Slovak analyses of that country's pension reform conclude that one of the main reasons for the need to revise the reform quite substantially within a few years of its adoption was that it was prepared and implemented too quickly and in the absence of a social consensus on reform; Lendacky (2008).

58. The blocked Italian pension reform of 1994 and the proposed US Social Security reform in 2005, both of which are covered in case studies, highlight the difficulties of trying to reform pensions rapidly, as does the defeat of the French government's pension proposals in late 1995.

59. Ross (2007) refers to these two processes as *de-legitimation* (the policy regime comes to be seen as a contributory cause of the policy problem rather than a solution) and *de-institutionalisation* (incremental erosion of the programme over time as a result of piecemeal early reforms).

60. Analyses that focus on political agency and the interplay of interests, treating policy regimes only as a dependent variable, often miss the significance of "reform ripeness", which figures more frequently in accounts emphasising the importance of institutions and path dependence.

61. The first attempt to reform Swedish sickness insurance not only represented a sharp reversal of course following a period of rapid *expansion* in the generosity of social insurances, it also cut against the prevailing approach to economic reform overall, which combined openness to competition with generous social protection.

62. This is particularly true in respect of proposed reforms of fundamental welfare-state institutions; see Ebbinghaus (2006:770).

63. This supports the view of Dewatripont and Roland (1994) that it may make sense to pursue reforms in sequence if they are complementary. See also Boeri *et al.* (2006:206-31).

64. For an example of this process at work in the pensions domain, see Palier and Bonoli (2000); and Palier (2007). Glazer (1992) goes further, in arguing that agents who have adjusted their behaviour in anticipation of a reform may even have put themselves in such a position that they would suffer losses if it were *not* implemented.

65. See James and Brooks (2001). In the present study, the French and Mexican cases, in particular, exemplify this trend. Poland does so in a modified form.

66. OECD (2007:175); Høj *et al*. (2006); and Boeri *et al*. (2006:216-19).

67. The Biagi law.

68. As noted above, only Spain, among the present set of cases, made any real progress in this respect, and the literature on labour-market reform highlights just how unusual the Spanish experience is. See, in particular, Saint-Paul (1996); Ochel (2008); and Bentolila *et al*. (2008).

69. On the "stealth reform vs transparency" debate, see Hirschmann (1968); Williamson and Haggard (1994); Pierson (1994, 1996); Rodrik (1996); and Arroyo (2008).

70. The 1995 Dini reform.

71. The initial presentation of the Hartz commission recommendations; as noted below, there were costly communications failures later on.

72. The 1994 pension reform proposals.

73. Specifically in respect of the implementation of the benefit reforms associated with Hartz IV.

74. In addition to the failed Italian pension reform of 1994 and the proposed US Social Security reform in 2005, both of which are covered in case studies, attempts at unilateral pension reform were stymied or reversed in France (1995) and Germany (1997). The Slovak reform was not reversed, but the adoption of a pension reform in the absence of a broad societal or political consensus was followed by a change of government and significant revision of the reform.

75. In fact, this particular point is less applicable to the Hartz reforms than to the *Bundnis für Arbeit*, which preceded them.

76. Williamson and Haggard (1994); see also Webb (1994) on the importance of the "ideological conversion" of policy-making and opinion-forming elites in sustaining crisis-induced reforms once the crisis has passed.

77. See Williamson and Haggard (1994); Rodrik (1996); and Arroyo (2008). Pierson (1994, 1996) argues that welfare-state retrenchment, in particular, can occur only via a policy of stealth. This view arguably finds support in the experiences of the many countries in which reforms have been successfully implemented with little prior consultation, often in the face of strong public opposition and at times in contravention of the declared policies of the governments undertaking them. See, for examples, Nelson (1990a, 1990b); Williamson and Haggard (1994) and Boeri *et al.* (2006).

78. This argument is expressed with considerable force in Sachs (1994). The corollary is that the existence of a prior social consensus will not prevent reformers from being punished for failed policies.

79. OECD (2007).

80. IMF (2004) confirms this frequently discussed "stylized fact" about structural reform: the short-term output consequences of structural reforms are often negative, although they can improve performance significantly over the longer run.

81. Card and Freeman (2002).

82. OECD (1995).

83. The Hartz case is an interesting example: the scandal at the Federal Employment Office in 2002 abruptly drew attention to the cost and ineffectiveness of prevailing policies.

84. The Productivity Commission and its predecessors, going back to the Tariff Board, have a long tradition of doing this, beginning with the first serious attempts to quantify the costs of Australia's then protectionist policies and to determine who bore those costs.

85. See Armingeon (2004, 2005); Eichhorst and Wintermann (2005); and Mahon and McBride (2008).

86. See Armingeon (2004) for an overview, and the associated studies of the Netherlands (Binnema, 2004); Sweden (Carroll, 2004); Italy (Bertozzi and Graziano, 2004); France (Serré and Palier, 2004); Spain (Álvarez and Guillén, 2004) and Germany (Zohlnhöfer and Zutavern, 2004). See also Armingeon (2005) and Mahon and McBride (2008).

87. Zohlnhöfer and Zutavern (2004).

88. Amingeon (2005); and Mahon and McBride (2008). The *Jobs Strategy* and other OECD studies were frequently cited in French parliamentary debates on the CIP and related reforms.

89. On the role of benchmarking, see Armingeon (2004); Carroll (2004); and Mahon and McBride (2008).

90. Haas (1992).

91. In Finland, a similar role has been played by the Finnish Centre for Pensions (www.etk.fi/Default.aspx?Lang=2).

92. The Czech pension reform of the early 2000s proceeded in similar fashion: while five major reform proposals were put forward by the major political parties, the cross-party working group that introduced the proposals prepared and analysed them under a common agreed framework, including common economic and demographic assumptions.

93. While recourse to such institutions can slow the policy process, they may also help prevent mistakes that might be made if the government were free to act in haste; the cross-correlation between time spent preparing the reform and the use of such institutions is both high (ρ=0.634) and significant.

94. The Polish BPR represents an intermediate case: it was not permanent, but it operated for five years under governments of both left and right, and was thus able to establish its authority and credibility.

95. A look at the two institutions' web sites reveals the marked increase in the salience of these issues in their respective work programmes *after* the first efforts at reform had run into difficulties.

96. Danziger's (1999) assessment of welfare reform research in the United States could apply to a number of policy regimes examined here.

97. Boeri *et al*. (2006).

98. Differences of opinion between the Ministry of Economics and Technology and the Ministry of Labour and Social Affairs.

99. The conflict here concerns divisions among congressional Republicans over the package.

100. Mainly differences between the regional and national branches of the main political parties.

101. Williamson and Haggard (1994:578-9) find that every successful case among the 15 episodes in their study has a coherent reform team, arguing that "the more vital factor is the existence of a coherent and determined government with adequate political support". Nelson (1990b:347) concludes, "The cases of clear failure [of reform] all traced collapse in large part to deeply divided economic teams." See also Piñera (1991).

102. The rank correlation between government cohesion and electoral mandates is 0.586, and that between cohesion and communications is 0.638. Both are statistically significant at the 5% level.

103. In the case of the 1994 Italian pension reform proposals, one coalition party justified its decision to oppose the reform while remaining in government by arguing that the proposals had not figured in the coalition agreement or the government programme and that the coalition parties were therefore not bound to them.

104. The labour minister was instructed to explore possibilities for reform but given no clear mandate.

105. See Harberger (1993); Williamson and Haggard (1994) and Piñera (1991) advance this argument chiefly in terms of chief executives, which is probably correct where large reform packages and major shifts in economic policy paradigms are concerned.

106. The Swedish postal reform is a case in point.

107. Drazen (2000).

108. When legislative or regulatory changes in market conditions leave companies or individuals stuck with investments that they would never have made if they had anticipated the change in the legal-regulatory regime, possibly rendering previously valuable assets worthless, the assets in question are said to be "stranded". In such situations, it is common to compensate investors, provided that (1) the cost of the asset has not yet been recovered and (2) it cannot be recovered by sale or alternative use.

109. See, in particular, Fernández and Rodrik (1991), who show how, given uncertainty about who will win and lose, a majority of risk-neutral voters may reject a reform that is expected to (1) generate net benefit overall and (2) benefit most voters. Nelson (1990b) adds time horizons to uncertainty, since agents discount the future.

110. Williamson and Haggard (1994:531) suggest that policy reform "is like an investment that should ultimately benefit the majority by enough to make them happy they made it, but that in the short run will – like all investments – involve sacrifices. The distribution of these sacrifices over time and across groups is at the heart of the politics of economic reform." See also Drazen (2000:432): "…agreement to enact a reform carries with it a distribution of the costs of reform."

111. Some object to generous compensation in principle, seeing it as tantamount to buying out rent-seekers when the elimination of rents and the move away from a "rent-seeking society" is the essence of economic reform. For sharply differing perspectives on the desirability of such an approach, see Bates (1994), Williamson and Haggard (1994); Koromzay (2004); and Delpla and Wyplosz (2007).

112. The experience of Italy's Treu reform was more typical: the side payments used to smooth its adoption were modest and aimed at small but strategically important parties whose co-operation was needed. They were not major elements of the reform bargain.

113. The 1995 Dini reform.

114. With the important qualification that corporatist processes worked *after* the BfA scandal and the Hartz report had changed the terms of the debate, strengthening the position of government reformers and putting the opponents of reform on the defensive.

115. In 1997; the 1994 reform was imposed by the government after corporatist consultations broke down; this experience strengthened the position of the government during the 1996-97 negotiations.

116. The coefficient for the pensions domain is not significant, but this appears to reflect lack of variation on the independent variable: in only one case (*Poland: farmers' social security*) did the evidence suggest that the government, which was both weak and divided, was unable either to act unilaterally or to punish non-cooperation on the part of other agents.

117. The pre-Hartz experience of the "Alliance for Jobs".

118. If the government is perceived to be divided over the policy, it will find it very hard to make any credible implicit or explicit threat to act unilaterally or punish non-cooperation; hence the high and significant cross-correlation between these two variables (ρ=0.661).

119. Boeri *et al*. (2006).

120. The Biagi law.

121. The issue does not appear to have been studied systematically in the political economy literature, but in the case studies examined here, partial or total reversals occurred only in respect of unilateral reforms. Negotiated reforms were sustained, even where significant criticism of, and opposition to, the agreed reforms subsequently emerged (*Italy and Spain: labour market*).

122. The 1995 Dini reform.

123. See James and Brooks (2001) on the use of this strategy in other countries.

124. In respect of the collective bargaining reforms adopted in 1994 and 1997 rather than the adjustments to EPL.

125. The 1995 Dini reform.

126. There are exceptions: the 1992 Italian pension reform, some changes to Polish pensions in the early 1990s, and the 1977 and 1983 US Social Security reforms.

127. Bonoli and Palier (2007); Bonoli (2008). Indeed, in Italy, the very long transition agreed for the Dini reform meant that only a very small minority of those who had reached voting age by 1995 would feel anything like its full impact.

128. Uncertainty on this score may encourage older workers to retire earlier rather than later, as they seek to claim their pensions before any further retrenchment can occur.

129. If pension benefits are viewed as deferred wages, then it may make sense for agents to accept adjustments in pension entitlements – in effect, a reduction in the rate of

return on their pension savings – in return for greater confidence that their benefits will be paid. See Immergut *et al*. (2007).

130. See, in particular, Ebbinghaus (2006) and Immergut *et al.* (2007).

131. In Germany, for example, there has long been a tradition of treating status-securing social insurance entitlements, based on dedicated contributions, as a sort of property right, whereas in the United States this is not the case.

132. Boeri *et al*. (2006).

133. This is the so-called "taxicab medallion problem"; see Koromzay (2004).

134. Moreover, the stranded asset problem was not limited to the irrigation sector. If changes in water policy prompted a shift towards less intensive dry-land agriculture and a corresponding decline in the farming population, then many rural communities would experience second-round effects, with schools, hospitals, banks and other services closing.

135. This is the logic that underlies many arrangements for automatic indexing of pensions and other benefits. See Weaver (1986); and Anderson and Zanardi (2004).

136. The Treu law.

137. The extension of the duration of so-called "UB I" benefits for older workers under Hartz IV.

138. The preservation of sectoral early retirement rights.

139. The principal short-term winners were South Australian irrigators. Being situated at the end of the river system, they had much to gain from water reforms that liberalised trade, since they tend to receive less seasonal allocations than upstream users when water is scarce, and from measures that addressed overallocation upstream. The South Australian irrigators and associated farm lobby groups are a strong private sector lobby group in favour of water reform.

140. This is not to suggest that older cohorts are anti-reform or that ageing societies reform less: Høj *et al*. (2006) find that rising old-age dependency ratios are associated with more product-market reform and with greater reductions in the implicit tax on continuing to work after 55. However, the case studies suggest that pension and labour-market reforms typically shield older cohorts from most of their effects, while many product-market reforms may be particularly beneficial to pensioners, since the price effects of greater competition are likely to be especially important to those on fixed incomes.

141. Rodrik (1994); and Drazen (2000).

142. See Visser (2007) for data on the age structure of trade union membership in 20 European countries.

143. Labán and Sturzenegger (1998) make this point with respect to the politics of stabilisation in Latin America, but it has a wider application.

144. Even when there is widespread agreement on the need for change, reform may be delayed by conflict over the allocation of costs; those with superior adaptive strategies – *i.e.*, those better placed to prosper even in the *absence* of policy change – have a significant bargaining advantage in such conflicts. See Alesina and Drazen (1991); Labán and Sturzenegger (1998); and Drazen (2000). To take a relatively banal example: better-off households tend to be less reliant on the public pension system for retirement income than poorer households. They therefore have less to

lose if that system proves unsustainable and hence less incentive to make sacrifices to shore it up.

145. See, in particular, Alesina and Drazen (1991); Labán and Sturzenegger (1998); Drazen (2000).

146. Buti *et al*. (2008); Williamson and Haggard (1994).

147. The average re-election rate for the period was around 30%, not counting cases in which the dominant party in a government coalition remained in office after the election but with new partners. The Australian electricity case is omitted, owing to the fact that a number of governments were involved over an extended period, some of which won re-election and some of which did not; the Mexican pension reform is also omitted, since the Calderón administration is still in power.

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