Reform prioritization and strategies:
Complementarities, packaging, sequencing

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Structural Reforms 2.0 Workshop, France Strategie, Paris, January 12, 2018
Key reform interactions: holistic lessons from the literature

Non-linearities
• Role of distance to frontier. Matters for prioritization and sequencing

Across reforms
• High-dimensionality problem in 2nd-best world ➔ stay humble
• Unclear whether there is reform complementarity across the board (e.g. labor and product market reforms)
• But multiple specific interactions seem to matter and can be exploited
  Examples: UB-ALMPs, TW-min wage, PMR-capital market, R&D-tertiary education...etc
• Political economy case for packaging may be stronger than economic case (past reformers)

Between reforms and business conditions
• Tension between economics and political economy of reforms in good and bad times (e.g. labor market reforms)

Between reforms and macro policies
• Macro policy support to reforms can ease the tension—and has done so in some success cases
• Aggressive counter-cyclical macro policy may also support longer-term growth in deregulated product markets
• ZLB and fixed exchange rate constraints: not serious issues—reforms are typically not/little deflationary
Some implications for reform strategies in EA context

Objectives and constraints
- Objectives: amplify ongoing recovery; resilience to future shocks; LT growth and convergence
- Constraints: Scarce fiscal space; scarce political capital; income inequality

Implications for prioritization/sequencing/packaging
- Premium on reforms that pay-off quickly and create momentum—PMR, some LM reforms in good times...
- ...and reforms that rebuild fiscal space—aforementioned indirectly + public spending/sector reforms directly...
- ...that, in turn, can:
  i) facilitate adoption of other reforms, creating further momentum
  ii) enhance resilience to future shocks—directly and indirectly by creating macro policy space
  iii) down the road fund fiscally costly reforms that are key to longer-term growth (higher education, innovation)

- Vast majority of reforms can be designed or packaged in ways that preserve or even enhance equity

- EU/EA-level reforms in parallel, to enhance macro effect of domestic ones—over and above their own impact on resilience Example: capital market union + PMR reforms ➔ intangible investment and growth.
Thank You!
Case studies of major past reform packages
(log GDP per capita, synthetic counterfactual obtained through synthetic control method)

Notes: Log(GDP per capita is shown). Estimates of counterfactual rely on the synthetic control method. Assumed treatment date = start of episode: AUS 1994, NZL 1991, NLD 1994. The two countries with the largest weights in the synthetic control groups are the United States and Greece (for New Zealand and Australia); Belgium and the United States (for the Netherlands). The number and estimated weights of other countries in the synthetic control groups vary across the four case studies. Vertical lines indicate the starting year of the reform episode.

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Effect of major past EPL reforms on sectoral employment: Unconditional impact vs. impact in major recessions (%)

Note: t=0 is the year of the major reform; dotted lines denote 90 percent confidence bands. The solid black (blue) line represents the unconditional effect (the effect in a major recession). The chart shows a sectoral effect, measured as the differential effect of employment legislation reform for a sector with relatively high natural layoff rate constraints compared to a sector with a relatively low natural layoff rate. Source: Duval, Furceri and Jalles (2017).
Simulated impact of PMR and EPL reforms in normal times, bad times, and bad times with binding ZLB

**Panel 1. GDP (Percent)**

1. Effect of PMR reforms

2. Effect of EPL reforms

**Panel 2. Unemployment (Percent)**

Effect of major past product market reform packages on output and public debt (%)

Panel 1. Output

Panel 2. Public Debt-to-GDP

Note: t=0 is the year of the major reform. Solid lines denote estimated effects. Dotted lines denote 90 percent confidence bands. Source: Banerji, Crispolti, Dabla-Norris, Duval, Ebeke, Furceri, Komatsuzaki and Poghosyan (2017).