How to gain political support for reforms?

V. Galasso, S. Carcillo, M. Castanheira, G. Nicoletti, E. Perotti, L. Tsyganok
How to address this question?

- **A priori:** many possible ways

- **Our goal:** provide hints to reformers

- **Our approach:**
  - Learn from past experience
  - Analyse successes and failures
  - Draw lessons for the future
Not a unique recipe

“**How**” to reform depends on
- Type of reform
- Electoral system
- Nature of opposition

“Framework conditions”

Yet: many common lessons are learnt
What has been achieved?

- Many reforms have been implemented
- Variation across countries and over time
Past regulatory reforms

- Timing and scope varies across countries
Past regulatory reforms

... and across industries
Labour market reforms

- Several reforms but both ways
Result: change is only marginal
Widespread phenomenon

- Pension reforms display a similar pattern
  (Marginal reforms, 1985-1996)
Current debate

- Economists’ “consensus”: *Structural reforms are needed*

- But:
  - few reforms actually implemented
  - those implemented are, at times, reversed

- Why do *and* undo structural reforms?
- Why such a slow progress?
Contents of the report

- Political economy aspects of reforms
- *Case study* approach
  - Pensions (Italy, UK)
  - Labour market (Denmark, Spain)
  - Product markets:
    - Regulatory reforms (Non manufacturing, OECD)
    - Privatisations (incl. transition countries)
    - Corporate governance (failures in Russia)
Three main issues

1. Why do politicians commit their “capital” to push forward a reform?
2. What stands on their way? Where do oppositions come from?
3. Do oppositions matter? Can they be circumvented?

⇒ How to reform?
1. Why do politicians commit their “capital” to push forward a reform?

- Economic opportunities
  (progress, globalisation, ...)

- Cost of status quo
  (crises: unemployment, ageing, ...)

- External constraints
  (new institutions, changes abroad)

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

- **Electoral incentives:** *losers*
  (politicians want to ensure reelection)

- **Status quo bias**
  (uncertainties: aversion to reforms)

- **Veto players**
  (institutions create own constituency)
3. How to reform?
A few possible “recipes”

- Exploit parliamentary majority
- Tailor reform to widen political base
- Divide & conquer
  - Divide oppositions
  - Trickle down effects
- Exploit external constraints
- Inform voters (reduce uncertainty)
Exploit parliamentary majority

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

- Constraints:
  - Parliamentary majority = political support (no veto player)
  - Party must ensure reelection (support along party lines)
Exploit parliamentary majority

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

- Target of the reform: Middle class
Exploit parliamentary majority

- Targeting the middle class

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Retirees’ Income by Income Group and Composition
Exploit parliamentary majority

- 1986: Thatcher pension reform
  - Retrenched public pension pillar (SERPS)
  - Introduced private pension funds
  - Accompanied by privatisations
- Target of the reform: Middle class
- Effect: created constituency (reelection)
Exploit parliamentary majority

- Ensuring re-election

<table>
<thead>
<tr>
<th>Year</th>
<th>Conservative Party</th>
<th>Labour Party</th>
<th>Liberal Democrats</th>
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<tr>
<td></td>
<td>Votes</td>
<td>Seats</td>
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<tr>
<td>1979</td>
<td>43.3%</td>
<td>339</td>
<td>36.9%</td>
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<tr>
<td>1983</td>
<td>42.4%</td>
<td>396</td>
<td>27.6%</td>
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<tr>
<td>1987</td>
<td>42.4%</td>
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<tr>
<td>1992</td>
<td>41.9%</td>
<td>336</td>
<td>34.4%</td>
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<tr>
<td>1997</td>
<td>31.5%</td>
<td>165</td>
<td>44.4%</td>
</tr>
</tbody>
</table>
Exploit parliamentary majority

- 1986: Thatcher pension reform
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  - Introduced private pension funds
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- Target of the reform: Middle class

- Effect: created constituency (reelection)

- Yet: partial reversal in 1999 (Blair)
“Pushing” reforms: momentum

- **Transition countries**
  - **Some countries**: fast reforms built support
  - **But**: *too much* “big bang”
  - **Also**: legislative reform ? implementation (Russia)

- **Rationale**: create “critical mass” effects
  - Coordinate expectations towards reforms
  - Shifts the debate & creates momentum
Other Cons:

- **UK**: partial reversal in 1999 (Blair)
- Imposing radical reforms not always feasible
- Often: *veto players* can block reforms

- Noteworthy failures:
  - 1994: Berlusconi’s pension reform
  - 1995: Juppé’s labour market reform
  - 2001: Rasmussen’s labour market reform
Failed Berlusconi reform

- Italy: Early retirees & Lega Nord support (1994)
2001

Italian regions (2001)
% early retirement

0.054 a 0.242  (6)
0.032 a 0.054  (3)
0.017 a 0.032  (6)
0.002 a 0.017  (5)

votes pro Lega

0.092 a 0.113   (2)
0.069 a 0.092   (1)
0.046 a 0.069   (1)
0.023 a 0.046   (4)
0  a 0.023  (12)
Next possible “recipe”

- Exploit parliamentary majority
- **Widen your political base**
  - Divide & conquer
    - Divide oppositions
    - Trickle down effects
- Exploit external constraints
- Inform voters (reduce uncertainty)
Widen your political base

- Confrontation strategy:
  - can create social tension
  - not feasible if veto players or if opposition crosses party lines

- Alternative way: social dialogue
  - spreading benefits over wider base buys out opposition

- Easier: when crisis occurs
**Widen your political base**

- *Flexicurity* in Denmark:
  - High flexibility on labour market
  - Generous unemployment benefits
  - Coalition government

- **1993**: unemployment peaks
Widen your political base
Widen your political base

- **Social dialogue:**
  - Successful 1994-1999 reform

- Need to “activate” job search
  - **Reform:** reduced generosity but rested on *compromise* (with unions)
  - **Target:** help least employable
Widen your political base

- Transition countries
  - Many reforms politically difficult

- Widen support:
  - **Mass privatisations** (Give-aways)
  - Economically costly, *politically* valuable
Widen your political base

Pension reform made successful: **Italy**

<table>
<thead>
<tr>
<th>Age Group</th>
<th>Amato Reform</th>
<th>Berlusconi Proposal</th>
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<td>- 4</td>
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<td>35-39</td>
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<td>55-59</td>
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<tr>
<td>60-64</td>
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<tr>
<td>Workers</td>
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<tr>
<td>Retirees</td>
<td>- 133</td>
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</table>
Next possible “recipe”

- Exploit parliamentary majority
- Tailor reform to widen political base

- **Divide & conquer**
  - Divide oppositions
  - Trickle down effects

- Exploit external constraints
- Inform voters (reduce uncertainty)
Divide and conquer strategies

- *Buying* opposition may be too costly

- *Divide* strong entrenched interests
  - Target particular sub-group
  - Not aimed at spreading benefits…but at concentrating costs
  - Reduce rents
Trickle down effects

“Divide” assumes *gradualism*

- Can have *chain reaction* effect within market (e.g. privatise to liberalise)…
- …or across markets (e.g. product to labour)

Increases rewards of other reforms

- Implement “easy” reforms first (reduced uncertainty, targeted groups)
- Risk: waiting for crisis situations
Divide and conquer strategies

- Non manufacturing:
  - Web of common interests
  - Cross political division lines
    - Entrepreneurs / Workers
    - Firms / Regulators

- Status quo creates constituency
  - Lack of international competition
  - Uncertain outcome if liberalisation
Divide and conquer strategies

<table>
<thead>
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<th>Dependent variable</th>
<th>Regulation net of public ownership</th>
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<td>Regulation in trading partners</td>
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Privatise / corporatise first
(Telecom Italia vs France Telecom)
Divide and conquer strategies

- Break vertical chain: intermediate goods
Divide and conquer strategies

Labour market:

- **Spain**: reform of temporary contracts in 1984, of permanent contracts in 1994 and 1997

![Graph showing Regular long-term employees / active population](chart.png)
Trickle down strategies

- Non-manufacturing: open up to trade

![Graph showing correlation between % reduction in regulation and % share of foreign affiliates in industry output. Correlation coefficient = 0.45* with p-value = 0.01.]

- Foreign affiliates and non-manufacturing reforms
Next possible “recipe”

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- Tailor reform to widen political base
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- **Exploit external constraints**
- Inform voters (reduce uncertainty)
Exploit external constraints

- Fierce opposition
  - Politically costly to reform…
  - …appeal to external constraints (WTO, EC)
  - Reduces government’s accountability

- Idea: change identity of pressure groups
  - Change “bargaining level”
  - Web of interests changes as well
Exploit external constraints

- Privatisation of Škoda
  - Political mood: “fear” of foreign ownership
  - Most privatisations: vouchers
  - Car producers: need external support

- Czech government
  - Committed to an efficient privatisation scheme, with VW
  - Repeatedly resisted pressure groups
  - EU accession: “external anchor”
Exploit external constraints

- **Privatisation of AvtoZAZ**
  - Few privatisations, few reforms
  - **AvtoZAZ**: on the verge of bankruptcy

- **Ukrainian government**
  - Protected *pressure groups*, above population
  - Privatisation meant to **prevent lay-offs**
  - **Lack** of “external anchor”
    → No ability to commit or resist pressures
  - Little or no “strategic” restructuring
Last, but not least

- Exploit parliamentary majority
- Tailor reform to widen political base
- Divide & conquer
  - Divide oppositions
  - Trickle down effects
- Exploit external constraints

- **Inform your electorate**
  (reduce uncertainty)
Inform your electorate

- Opposition to pension reform
  
  *Do you want to shrink the welfare state?*
  
  - Informed: *yes*
  - Not informed: *no*

- **Informing** about costs and benefits changes attitudes
  
  - Successes in other countries and sectors
  - More difficult when networks, externalities,…
Summing up......“recipes” to reform

- Exploit parliamentary majority
- Tailor reform to widen political base
- Divide & conquer
  - Divide oppositions
  - Trickle down effects
- Exploit external constraints
- Inform voters (reduce uncertainty)