# Fiscal Consolidation and Structural Reform: Getting it Right

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**Introductory and Concluding Comments by the Chairman of Session 1**

**"Making Reform Happen"**

**Conference organized by the OECD and the Korean Development Institute**

**25-27 November, 2010, Paris**

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## Introductory Comments

How do you make things happen? How do you go from the policy vision to the reality of fiscal consolidation and structural reform. The political economy of reform is the topic we will be dealing with in Session 1. Perhaps the answer is best summed up in a joke. "Question: How many psychiatrists does it take to change a lightbulb? Answer: only one, but the lightbulb must really want to change". The need to get the public on side, to recognize the need for change, seems to me to be indispensable to make things happen. I will come back to this in a moment.

If implementation is arguably the toughest part of introducing new policies, there are also two other problems that need to be resolved before actually getting to the implementation stage. I call them the "acceptance" problem, and the "identification" problem. Over the years, the OECD has made significant efforts to overcome both. Now, with its new focus on the "implementation" problem, the OECD can rightfully say that it has tried to address all the policy stages from conception to completion. Let me say a few words about the OECD's contributions at each stage.

**The Acceptance Problem**

At the analytical level, it first has to be accepted that there are good ways to run an economy – promoting sustainable growth, resilience and fairness – and bad ways. With respect to structural reforms, the OECD has carried out an immense amount of analytical work over decades into how to improve the functioning of labour markets, product markets, pension arrangements, social policies (particularly education and health) fiscal policy, environmental issues, and a host of other topics. In many areas, there is now a body of agreed principles ("evidence-based") on what is helpful in what is not. Of course, this is not to deny the point made by Mr Hyun in his Opening Remarks that in many areas the jury is still out. In short, the analytical work on structural reforms sponsored by the OECD will have to continue, not least because the world itself is constantly changing. This, in turn, can call into question even principles once thought fully agreed.

Accepting the need for fiscal consolidation poses more difficult analytical problems. One aspect of this is that theory provides little if any guide as to when sovereign debt levels begin to weigh on growth potential, or when financial markets might react adversely to the perceived problem of either debt or deficits being too high. The impact on the economy of fiscal tightening is also open to serious debate. Yet, recent market developments, not least with respect to the sovereign debt of some of the smaller countries in Europe, has clearly changed the balance of the arguments in favour of more fiscal consolidation. In some countries, this is already well advanced in spite of the recovery from the crisis being very slow. In contrast, in some other countries, planned fiscal consolidation is being held off until the recovery strengthens.

**The Identification Problem**

Some of you may have read the new book by Carmen Reinhart and Can Rogoff ("800 years of Financial Folly; This Time It's Different"). Everyone, and every country, wants to believe that it is "special" and that the advice which applies to others does not apply to them. The OECD has made a significant contribution in this area as well. It is the committee that I chair (the EDRC) which tries to identify, country by country, the "broad" insight from the OECD's analytical work that could usefully be applied to the country in question. And I must repeat "broad" insight, because all countries are different in some important respects and lessons evidently have to be applied case-by-case.

**The Implementation Problem**

Philosophers over centuries have wrestled with the problem of "the will to act". This problem afflicts all policymakers, not least when times are good and the natural tendency to project these good times into the future prevails. By way of example, consider the behaviour of central bankers and regulators during the period of "the Great Moderation" which preceded our current crisis. But, in addition, implementing new policies raises a large number of practical questions for which there are in fact no agreed answers. Indeed, in many cases, implementation issues reveal only tradeoffs between desired outcomes rather than good or bad results. Evidently, in democratic societies this could open the door to almost endless debate. A few such issues can be highlighted.

One such issue has to do with the choice of **strategy** for the implementation of structural reforms. Each choice has its own set of difficulties. Suppose you have chosen to implement only one set of reforms: how can you deal with the vested interests opposing reform?  Should you ignore or engage? Should you buy them out or grandfather them. Suppose there are a number of reforms to implement: what is the proper order of sequencing? Should product market reform precede labour market reforms and both precede financial sector reform? Or the opposite? And suppose you are forced (like the transitional economies) to undertake simultaneously a whole host of reforms that will be truly transformational? How can you prevent this process being taken over by those with only their own interests at heart?

Another issue has to do with **timing**. Are reforms better done in bad times or good? In the upturn it is hard to get agreement on the need for reform, but given such agreement there would be funds to buy off the vested interests. Conversely, in the downturn it is easy to agree on the need for change, but there may no resources to finance it. One possible answer is to pass legislation in bad times that will only be implemented later. This was the strategy followed by Canada in its successful fiscal consolidation dating from the late 1980’s.

A third issue has to do with the **compatibility** of the need for fiscal consolidation and the need for structural reform revealed by the current financial and economic crisis. Potential in the OECD area is estimated to have fallen by about three percentage points while sovereign debt levels have literally exploded in many countries. Structural reforms would evidently help to alleviate both problems over time, but the emphasis must be “over time” Shorter term, the lack of fiscal capacity could conceivably impede structural reform for reasons alluded to above. Conversely, the need for fiscal consolidation might provide a framework to spur structural reforms, not least having to do with the efficiency of the provision of government services.

Recognizing all these dilemmas and unanswered questions should not blind us to the fact that we have also learned a great deal over the years about the process of structural reform, and what distinguishes successful reforms from unsuccessful ones. The various documents circulated in the package prepared for you today are very enlightening in this regard and I strongly encourage you to read them when you get the opportunity.

Today we have a distinguished group of speakers. All three have participated in reform efforts that succeeded. They may even be prepared to tell you about some of their efforts at reform that were less successful. I hope that in referring to their experiences, they will also address some fundamental questions: namely; how serious are the dilemmas I just pointed to; how might they be overcome and what are the critical factors for successful policy reforms?

## Concluding Comments

To summarize what we have just heard, our panellists do feel that structural reforms do improve significantly the functioning of the economy, albeit only over time. Moreover, in many countries, structural reforms are really the only game in town with both monetary and expansionary fiscal policies clearly having reached (or perhaps even exceeded) their usefulness. In countries with large external deficits, this would seem obvious. However, a related point can be made about some countries with large trade surpluses. They need structural polices to reorient production towards domestic services rather than to the production of still more tradeables.

Implementing both structural reforms and fiscal consolidation requires, above all, getting the public on side. They must be made to see that the potential costs of doing nothing in the face of these challenges could be very high. Education, engagement, persistence and the building of trust are all of crucial importance if leadership from policymakers is to be effective.