Claeys, Peter

Article
On measuring structural reform

Romanian Journal of Fiscal Policy (RJFP)

Provided in Cooperation with:
Romanian Journal of Fiscal Policy (RJFP)

Suggested Citation: Claeys, Peter (2015) : On measuring structural reform, Romanian Journal of Fiscal Policy (RJFP), ISSN 2069-0983, Editura ASE, Bucharest, Vol. 6, Iss. 1, pp. 17-27

This Version is available at:
http://hdl.handle.net/10419/168627

Romanian Journal of Fiscal Policy
Volume 6, Issue 1(10), January-June 2015, Pages 17-27

On Measuring Structural Reform

Peter Claeys
Faculty of Economic and Social Sciences, Department of Applied Economics, Vrije Universiteit Brussel

ABSTRACT

Indicators of government activity must be carefully designed to be relevant, credible and accountable. Frustration with reform pressures suggests that measures of policy activity are not providing accurate information. In fact, indicators of product or labour market regulation fail to measure structural reform as they focus on cross-country comparisons rather than on progress with reform over time. I use the novel EU Semester approach recommending EU Member States to implement reforms and their annual follow-up in the National Reform Programme to develop some indicators of how reform plans are actually implemented. This indicator might be useful for checking progress with policy, but also for empirical studies testing what drives or blocks reform in different policy domains.

Key words: structural reform, regulation, indicator, fiscal policy, EU

JEL Classification: C89, E69, H00, H89

1. Introduction

Macroeconomic studies typically look at the economic impact of additional government outlays. Government policies span a much broader area than budget decisions, however, and many involve modifications of legal settings that do not always carry a direct budget cost. Measuring this kind of government activity is therefore not straightforward. It is however becoming increasingly important to understand the progress governments make in different areas of structural reform as they are on the top list of the political agenda in many countries, often with much controversy. While structural reforms are seen as necessary to preserve economic sustainability or competitiveness in the longer term, the electorate is less convinced of the pressure to reform or the types of reforms to commence. The agenda of labour or product market reforms in the proposals of international organisations, like the

OECD's Going for Growth, or in the EU's recommendations to Member States, or by governments of different ideologies, have met with fierce resistance. Economists have often expressed frustration at the lack of reform. Politicians instead ventilate their opposition to the speed or types of reforms being asked for, or argue reform in many areas is already underway but takes time. The public at large have ambiguous feelings on the scope and balance in the types of reforms being implemented.

One of the reasons for these misunderstandings on structural reform is that the types of indicators for measuring policy activity are not providing the right information. First, many policy indicators are not relevant as they bear no direct link to the policy. Kraay and Tawara (2013) demonstrate that indicators of the regulatory and institutional environment that matter for one outcome are, on average, not important correlates of other closely-related outcomes, hence they cannot be employed for targeting specific reforms in different contexts. Economists might consider this link to be important, but politicians may see little benefit in targeting this type of outcome then. Second, many policy indicators are not directly actionable by the government, and so weaken the link between policy decisions and the final desired outcome. Government can modify legislation, but these judicial changes do not always imply effects on the field directly. Policy indicators are therefore of limited use. By contrast, outcome indicators can be designed so as to capture specific reforms on which government action has a more direct leverage. Finally, good policy indicators should be easily interpretable and allow follow-up so as to keep government accountable for its actions. Existing policy indicators only allow comparing the levels of product or labour market regulation across countries, and are being used to rank countries. Those rankings only measure relative positions, but they do not measure the structural reform as such. While policy or outcome indicators give a sense of the degree of reform that is required as compared to other economies, the variety in country-specific settings thwart accountability for governments with their electorate.

In this paper, I propose to tackle the last problem by developing an indicator to measure progress with structural reform over time. Since 2010, the EU has started to issue annual Country-Specific Recommendations (CSR) in its Annual Growth Survey under the Europe 2020 plan with specific proposals to tackle structural logjams that brake economic growth. The Europe 2020 plan is the successor of the Lisbon Strategy as the latter met some difficulties in keeping national governments accountable for progress in reform. Stronger governance of the reform process should now be guaranteed by regular and transparent monitoring and raising ownership at national level (EC, 2010). National governments are now required to follow up on the CSR by detailing progress with the different recommendations in the following budget year, and report this in the National Reform Programmes (NRP).

We use this annual follow-up information to develop a set of indicators – first developed in Claeys *et al.* (2013) – to measure structural reform efforts. In order to be able to make a quantitative assessment of the implementations reported in these NRPs, each CSR is further disarticulated in detail and then classified in six policy domains. I then define different degrees of implementation with each of these reported policy actions, as reported by national governments. We can so measure the progress that each EU Member State has realised on specific policy domains.[1]

This indicator is useful for keeping track of structural reform in different areas and keeping governments accountable for reform slack. As this is an outcome indicator of government activity itself, it is directly 'actionable' by governments so that it aids credibility. Besides the

[1] The most closely related indicator to measure reform is the LABREF database from the EC that covers the pace and type of labour market reforms in EU Member States since 2000 (Turrini *et al.*, 2014).

direct policy interest, reform indicators can be used to test different theories on structural reform, in particular regarding the timing and pace of reform. An extensive theoretical literature has argued that policy reform damages electoral chances. Hence, on the one hand, reform is more easily implemented during macroeconomic booms as the bar is raised even for potential losers of the reform (Saint-Paul, 2006) but on the other hand, resolute reform action during a deep crisis is often awarded by the electorate (Alesina and Perotti, 1997). Reform also carries a budget cost, so that budget restrictions may constrain government action (Poplawski-Ribeiro and Beetsma, 2008). Empirical evidence on the timing and pace of structural reform is limited as the types of indicators currently in use do not allow checking progress over time, as for example in Alesina *et al.* (2010).

This paper next discusses the details of the EU Country-Specific Recommendations (section 2) to discuss then the classification of different policy measures (section 3). This classification is then assessed on its degree of implementation in section 4. Section 5 discusses some applications of the indicator.

2. The EU Country - Specific Recommendations

The Country-Specific Recommendations are proposed annually by the European Commission in May on the basis of country-specific analyses and the EU-wide policy priorities defined under Horizon 2020 and presented in the Annual Growth Survey. The Recommendations are endorsed by the European Council and adopted by the Council at the end of the Spring cycle of the European Semester, in July of each year.

The analysis of the follow-up by national governments of the Recommendations is a crucial step in the European Semester: as the Recommendations are endorsed by the European Council and adopted by the Council, it is assumed that national governments will act on the basis of the Recommendations to stay in line with EU policy objectives.

Lack of progress in a determined time frame may give rise to warnings, and, in the case of excessive macroeconomic imbalances or budget deficits, to potential sanctions. These are handled under the Macroeconomic Imbalance Procedure (MIP) or the Excessive Deficit Procedure (EDP). The assessment of progress on the implementation of previous year's CSRs is moreover a valuable input for the Commission in formulating the CSRs for the next European Semester Cycle, for the Council in deciding whether to adopt those CSRs, and for the political debate more generally.

We examined the CSRs adopted by the Council during the 2012 Semester Cycle, and evaluated the progress that each EU Member State reported with regard to their implementation in the Stability and Convergence Programme and the NRP.[2]

3. Classifying Policy Reform

3.1.The legal classification

The CSRs issued during the 2012 European Semester contained a number of recommendations on various policy areas. The first recommendation was always related to the pursuit of budgetary stability, and contained detailed recommendations regarding

[2] Member States under a macroeconomic assistance programme – Greece, Portugal, Ireland and Romania – did not receive recommendations in 2012 as they were being monitored under macro-economic adjustment programmes.

medium-term budgetary objectives, expenditure benchmarks or budgetary frameworks. The other recommendations cover other issues not related specifically to the budget.

The first column of Table 1 shows the total number of CSRs the EC and the Council issued for each Member State: it ranges from 4 for Germany to 8 for Spain. The second column shows how many of these CSRs were issued under the Macroeconomic Imbalance Procedure (MIP): 10 countries were considered at risk of macroeconomic imbalances in 2012, and the number of MIP-recommendations ranged between 1 (Sweden) to 5 (Spain).

Table 1 Total number of recommendations

	number of CSR	of which MIP	number of detailed
Belgium	7	4	21
Bulgaria	7	2	30
Czech Republic	6	0	19
Denmark	5	3	14
Germany	4	0	16
Estonia	5	0	19
Spain	8	5	34
France	5	3	18
Italy	6	4	24
Cyprus	7	3	17
Latvia	7	0	21
Lithuania	6	0	19
Luxembourg	5	0	9
Hungary	7	4	20
Malta	6	0	18
Netherlands	5	0	15
Austria	7	0	21
Poland	6	0	24
Slovenia	7	3	19
Slovakia	7	0	24
Finland	6	0	15
Sweden	4	1	6
UK	6	3	15
Sum	139	35	438

Notes: CSR related to MIP are available only for countries which had been considered at risk of macroeconomic imbalances in the Commission in-depth-reviews of 2012. Source: Claeys et al. (2013).

The content of the recommendations varied across the Member States, and could cover different policy actions on which governments were recommended to act. For example, a recommendation on labour market reform could contain specific recommendations to reform wage indexation systems, to develop vocational training schemes to reduce youth unemployment, or to increase the performance of public employment services. We therefore divide up each recommendation into specific sub-items. In the labour market reform example above, if a CSR (say the third CSR) covered various aspects of labour market reform, we split it into CSR 3a on wage indexation, CSR 3b on vocational training and youth unemployment and CSR 3c on public employment services.[3]

[3] The detailed recommendations are presented in the country tables in the Claeys *et al*. (2013).

The third column of Table 1 presents the number of detailed recommendations per Member State obtained from this partition. We observe much more variation in the number of detailed recommendations than in the number of CSRs: the number of detailed recommendations varies from 6 to 34. Spain (34), Bulgaria (30) and Italy or Poland (24) are the countries with the highest number of detailed recommendations, while the lowest numbers are observed for Denmark (14), Luxembourg (9), and Sweden (6). As there are 139 CSRs in total, and we derived 438 detailed recommendations, each CSR contains on average about three detailed items.

3.2. A Classification Per Policy Domain

Each of these 438 detailed recommendations was then classified into one of six policy domains: fiscal policy, labour market, social policy, market policy, the environment, and financial markets. These domains do not correspond to the different headings under which the Commission categorises the CSRs.

Recommendations arguably do not uniquely fall in one of these domains: for example, a recommendation to improve vocational training improves the functioning of the labour market, but has a social dimension too. Nevertheless, we choose to order each detailed recommendation in a single domain using a set of criteria.

First, the domain of fiscal policy includes all recommendations relating to the progress towards medium-term budgetary objectives and the sustainability of public finances. It further concerns measures to reform public spending and taxation. The domain also covers recommendations like the set-up of fiscal rules or a fiscal council, the control of regional budgets, or measures to improve budget reporting. Second, the labour market category includes all recommendations related to reforms of the structure of labour markets, such as those addressing: the wage bargaining system, labour productivity, unemployment (in particular amongst elderly and the youth), active labour market policies and participation rates (employment for older or younger people, or discrimination of women and migrants). Third, the category social policy includes recommendations under the EU strategy for socially inclusive growth that aim at improving economic and social conditions, through promoting education, and combating poverty and discrimination. Fourth, the area of market policy includes recommendations related to improving the functioning of markets for goods and services (such as the liberalisation of products and services markets), international cooperation, innovation and research, legal settings or the quality of public administration. Fifth, the category environment contains all issues related to environmental policies, with special focus on the reduction of carbon emissions and the more efficient use of energy. Finally, the financial market domain includes all recommendations related to the banking sector (e.g. supervision) and regulations that may determine the financial stability of the country (private sector debt, private sector credit flow and the functioning of the housing market).

Table 2 summarises this information and shows the number of detailed recommendations in each domain per country. Most recommendations were issued in the domains of fiscal policy (153), labour markets (106) and market policy (100), while recommendations on social policy (45), financial markets (26), or environmental issues (8) are less frequent. Fiscal and labour market related recommendations constitute actually more than half of all recommendations in each country, except in Bulgaria, Denmark or the UK.

Table 2 shows also some variation across countries by policy domain:

- In the domain of fiscal policy, Slovakia and Spain received the highest number of recommendations. For both countries, fiscal policy is also the domain with the most frequent number of recommendations (about one third in Spain, and more than a half in Slovakia).

- Spain also has the highest number of recommendations on labour market issues. Belgium, Luxembourg, France and Sweden also receive a high number of recommendations in this area.
- Although measures to further open up markets are requested to all countries, the country where measures aimed at market liberalisation and improvements in administration were most frequent was Bulgaria. The Czech Republic, Lithuania, and Finland also received a relatively high number of recommendations in this domain.
- Bulgaria also received the highest number of recommendations on social policy, followed by Estonia. Latvia, Poland and Slovakia have also been asked to undertake efforts in this area.
- There are only few recommendations in the area of environmental policy, and only Belgium and Estonia have been requested to make progress on at least two actions.
- Regarding financial markets, recommendations were concentrated on few countries. Spain was recommended to take action on four issues, and the Netherlands, Denmark and Slovenia on three each. Other countries received some recommendations on financial markets: Sweden received only six detailed recommendations in total, but two of them referred to financial markets.

Table 2 Detailed CSR classified by domain

	fiscal policy	labour	social	market	environmen	financial
Belgium	7	8	0	3	2	1
Bulgaria	7	3	7	13	0	0
Czech	5	5	3	6	0	0
Denmark	2	3	3	3	0	3
Germany	7	2	2	3	0	2
Estonia	7	3	4	3	2	0
Spain	11	11	2	6	0	4
France	6	6	1	5	0	0
Italy	9	6	2	7	0	0
Latvia	7	3	4	6	1	0
Lithuania	9	4	0	6	0	0
Luxembourg	2	6	0	0	1	0
Hungary	8	4	2	6	0	0
Malta	8	5	1	1	1	2
Netherlands	7	2	0	3	0	3
Austria	8	6	2	3	0	2
Poland	9	4	3	7	1	0
Slovenia	6	5	1	4	0	3
Slovakia	13	6	3	2	0	0
Finland	4	6	0	5	0	0
Sweden	1	2	0	1	0	2
UK	3	3	3	4	0	2
sum	153	106	45	100	8	26
average	6.65	4.61	1.96	4.35	0.35	1.13

Source: Claeys et al. (2013)

4. Measuring Policy Reform

Based on the detailed recommendations, we then analysed the 2013 NRPs to identify the policy actions that national governments reported in order to implement the 2012 recommendations. National governments are supposed to provide information on the implementation each of the CSRs issued in 2012. In general, their reply to the first recommendation on budgetary stability was presented in the Stability and Convergence Programme, meanwhile information referring to the other CSRs was included in the NRP.

Measuring progress with the implementation of the CSRs requires a clear definition of the action, the extent of the action, as well as its timing. The measures that we considered as policy actions are various: they might be laws, amendments to laws, or similar legal measures (like decrees, ordinances, or administrative changes), but also measures that do not actually require a legal change and might rather refer to an action plan, or to an agreement between the government and regions, social partners, or with other countries.

We classified policy actions into five categories of implementation:[4]

1) **not done**: if the government
    a) does not mention any action at all in response to the recommendation
    b) refutes the interpretation of the detailed recommendation, and considers it to be incorrect or irrelevant
2) **not specified:** if the government
    a) mentions some action has been taken, but does not provide detail on the way this action has been achieved
3) **promise**: if the government
    a) has set up a committee, commission or working group to discuss the implementation of the CSR
    b) states that it is considering, or planning to consider, the CSR in the future
    c) states to be committed to implement the measure but made no specific steps
4) **partially implemented**: if the government
    a) is committed to implement the measure or several steps, but the overall implementation is still on-going. This is the case when some – but not all – necessary legal measures have been taken,
5) **done**: if the government
    a) has fully implemented the measure, i.e. all legal changes have been introduced.

The analysis is limited to evaluating those measures that are mentioned or announced in the NRP, and are under direct control of the government. Hence, the aim was not to verify whether the policy actions were actually being implemented, nor to check if the objectives of a certain measure were achieved. For example, if the recommendation required a reduction of youth unemployment, we did not measure progress in terms of an actual reduction, but took note of the actions that the government had reportedly taken to achieve this goal. The indicator is thus a policy indicator.

[4] This approach is not identical to the one used in the implementation assessment by the EC, which also includes information from bilateral meetings and country visits.

We synthetized the information available in the NRP by classifying each detailed recommendation into a single category of implementation. For example, suppose that in the case of a detailed recommendation that required a change in the pension system by raising the retirement age and adapting its indexation, two measures were initiated by the government according to the NRP. One was a legislative change on the retirement age already approved in parliament, and another one was a proposal to modify the contribution system, but was still under discussion with social partners. In this case, the recommendation was considered as partially implemented.

If the government took several actions that were at different stages of implementation, we choose to classify them by the average level of implementation. Consider the same example of the pension system recommendation previously discussed: since the government introduced a legislative change and a proposal of law that was still under discussion, the progress in the pension reform was classified as partially implemented, because the law was not yet implemented but some progress had been made. This evaluation was based on an assessment of the overall progress in this area, and required some subjective evaluation.

In order to measure progress, we checked the timing of each policy action. The status of progress was assessed by specifying whether each measure was implemented already by 2012, or whether it is planned to be introduced in 2013 or beyond.[5]

Table 3 summarises the status of implementation of the detailed recommendations. The bottom row shows that on average, 35% of the detailed recommendations have been implemented and 32% have at least been partially implemented. This implies that nearly two thirds of all measures are at least on track. A further 22% is promised to be carried out: that implies that just 11% is not specified in the NRP or not followed up at all.

[5] Furthermore, it should be noted that we did not consider evidence on any additional actions governments might have taken in other fields. Most NRPs report in a detailed way on the CSRs and the corresponding government actions, but also refer to other actions or reforms that are not necessarily related to the CSR. In some countries, this additional information is quite substantial (Spain, Italy or Belgium). This information was ignored in the analysis, as it did not strictly pertain to the implementation of the CSRs.

Table 3 Detailed recommendations classified by status of implementation

country	total	*not done*	*not*	*promise*	*partially*	*done*
Belgium	21	14	5	0	67	14
Bulgaria	30	17	3	13	47	20
Czech	19	0	0	53	16	32
Denmark	14	14	0	29	0	57
Germany	16	6	19	44	31	0
Estonia	19	11	0	63	26	0
Spain	34	3	0	29	12	56
France	18	0	11	22	50	17
Italy	24	0	0	17	38	46
Cyprus	17	12	0	6	29	53
Latvia	21	0	5	10	48	38
Lithuania	19	11	5	11	21	53
Luxembourg	9	0	0	0	11	89
Hungary	20	5	15	25	40	15
Malta	18	6	0	39	44	11
Netherlands	15	0	7	40	13	40
Austria	21	5	5	10	24	57
Poland	24	17	4	38	38	4
Slovenia	19	5	11	11	11	63
Slovakia	24	0	0	29	38	33
Finland	15	0	0	13	40	47
Sweden	6	0	17	0	17	67
UK	15	0	13	13	73	0
average	19	6	5	22	32	35

Source: Claeys et al. (2013)

Although the overall outlook seems quite satisfactory and suggests that governments take the CSRs seriously, these averages conceal wide differences in the degree of implementation across countries, as some made much less progress than others. Only nine Member States have fully implemented more than half of all the detailed recommendations. Out of the 14 other Member States, three that have not fully implemented any measure (Estonia, Germany, and the UK). However, the picture is not as negative when we take into account the percentage of partially implemented measures. Only four Member States have not been able to implement fully or partially at least half of all the measures (the sum of the last two columns in Table 3 (i.e. Estonia (26%), Germany (31%), Poland (42%) and the Czech Republic (48%)).

Most Member States have started a substantial number of policy actions, even if they did not fully implement a lot of them. This is the case for Belgium, Bulgaria, Hungary, and Malta. The time frame over which actions can be fully implemented seems to vary across countries, probably due to the electoral calendar, the complexity of the specific reform, institutional structure, etc..

Some Member States moved forward with a major part of recommendations. Finland, Latvia, Sweden, Italy, Cyprus, Austria and Belgium started to implement at least more than 80% of all detailed recommendations, and Luxembourg has actually partially or fully implemented 100% of all measures.

Some Member States made specific references to the recommendations when planning their implementation in the near to long-term future: promised reforms are either at the planning or the discussion stage, or are still under negotiation. Member States with many promises of future implementation were Estonia, Germany, the Czech Republic, and also the Netherlands, Malta and Poland.

A variety of reasons can account for the differences in implementation across Member States. For some countries, the electoral calendar may slow down the execution of the recommendations, while in other countries, at the start of a new government it may take time for it to start implementing the measures. The complexity of the reform or the negotiations within the national framework may prolong the implementation process too. For example, abolishing restrictions to some professions is an easier reform than an overhaul of the judiciary system. However, there is little evidence of differences in the status of implementation across policy domains. Table 4 below shows the average (percentage) degree of implementation by policy domain. In general, progress with policy actions turns out to be quite uniform across domains. The majority of actions have been completed, or at least partially implemented the recommendations. Only for social policies nearly half of all actions are shifted to the future as promises. The reason might be that not all social policy measures can be introduced at once, and require prior negotiation with social partners. However, a similar delay in labour market policy cannot be detected, even if the social partners supposedly have a larger voice in this area. By contrast, measures on financial markets and the environment have been fully or partially implemented in the majority of cases.

Table 4 Status of implementation by domain (frequency in %)

	not done	not specified	promise	partially	done
fiscal policy	8	8	23	21	39
labour market	5	4	18	41	33
social policy	0	2	44	38	16
market policy	7	1	23	41	28
environment	0	0	13	63	25
financial markets	4	4	15	23	54
total	6	5	22	32	35

Source: Claeys et al. (2013)

5. Conclusion

Frustration with reform pressures both from the side of economists, politicians and the public at large are the result of the short-term pain and the long-term gains associated with reform. Measures of policy activity are however not always providing accurate information. In fact, indicators of product or labour market regulation fail to measure structural reform as they focus on cross-country comparisons rather than on progress with reform over time.

Relevant indicators that are actionable by the government and increase accountability of its actions to keep progress with structural reform on track and under control would inform the public debate. This paper proposes a novel set of indicators based on the EU Semester to keep EU Member States accountable for their reform efforts on a broad set of policy domains. The indicator measures implementation of reforms using information in the National Reform Programme. This indicator might also be useful for empirical studies testing what drives or blocks reform in different policy domains.

References

Alesina A., Perotti R., 1997. Fiscal Adjustments in OECD Countries: Composition and Macroeconomic Effects. IMF Staff Papers, vol. 44(2), pp. 210-248.

Alesina A., Ardagna S., Galasso V., 2010. The Euro and Structural Reforms, in: Alesina A. and Giavazzi F. Europe and the Euro, NBER, pp. 57-93.

Claeys P., Dreger C., Moreno R., Carrion J., C., 2013. The European Dimension in the National Reform Programmes and the Stability and Convergence Programmes, European Parliament, Economic Governance.

Kraay A., Tawara N., 2013. Can specific policy indicators identify reform priorities?. Journal of Economic Growth, vol. 18, pp. 253-283.

Poplawski R. M., Beetsma, R., 2008. The political economy of structural reforms under a deficit restriction. Journal of Macroeconomics, vol. 30(1), pp. 179-198.

Saint-Paul, G. (2004). Macroeconomic Fluctuations and the Timing of Labour-Market Reform. pp. 119-129,Palgrave Macmillan UK.

Turrini A., Koltay G. Pierini F., Goffard C., Kiss A., 2014. A Decade of Labour Market Reforms in the EU: Insights from the LABREF database, European Economy. Economic Papers no. 522.