

Il Sole **24 ORE**

Mr Renzi and the "Win-Win" Political Economy of Reform

By Alessandro Leipold, 30 May 2014



The result achieved by Italy's Democratic Party and the Renzi government in last Sunday's European election is truly exceptional. Not only for its unprecedented size, and for having been obtained by an incumbent party, but above all for what it expresses: an extraordinary degree of confidence – or at least of hope – in the power of reforms, and a huge, unquenched thirst for change. The country, drained by years of promises of unrealized "liberal revolutions," yearns to finally free itself of the many shackles that not only stifle economic growth, but degrade the daily life of each of its citizens.

The opportunity is truly momentous. Either reforms are implemented, and implemented well, so as to achieve the sought-for results, or the very concept of "structural reforms" will acquire the same bad name as that of the adjustment-austerity equation. The popular consensus around the need for reforms is a precious and rare treasure. It must be safeguarded, or otherwise risk eliciting an adverse reaction leading to the country's economic and political drift. The issue is therefore not simply of knowing "what to do," but also of "how to do it," so that the reforms' success secures continued democratic backing – which is their very lifeblood. There is, in other words, a need to draw lessons from the political economy of reform, i.e., from the

positive experiences of other countries, where reforms not only yielded the expected results in terms of growth and employment, but also had a political pay-off for the governments that undertook them.

The factors making for the success of structural reform efforts have been most closely reviewed by the OECD. Two studies stand out in this regard, published in 2009 and 2010, when Minister of the Economy Pier Carlo Padoan was the organization's Chief Economist and Deputy Secretary-General. The following summarizes their main findings.

A first ingredient for success is to have an electoral mandate for reform. This, as argued by *Il Sole 24 Ore's* director, Roberto Napolitano, on May 27, has been amply secured. The government's reform intentions were well known: the vote endorsed them. There is no need to proceed with caution, for fear of surprising the electorate, nor to resort to "reform by stealth" (as practiced at times in France, with scant results). A second important ingredient of success lies in effective communication about the need for reform. Again, fortunately, progress has already been made, thanks to the abandonment of language of the type "Italy must do its homework" or "needs to do what Europe asks." Reforms are imperative not because demanded by Europe (currently furthermore in disrepute), but because invoked by Italian citizens who recognize their need. Without such a sense of ownership, reform efforts run aground and sink. Finally, the success of reforms depends also on the "ripeness" of the sectors being targeted – understood as a clear awareness of the unsustainable costs of the status quo. In this regard, there is little doubt about the "reform ripeness" of the electoral and constitutional set-up, the labor market, public administration, and justice, not to mention the long-awaited spending review (indeed, were it only mentioned more often).

So far, so good, then. But here comes the rub. The design of reforms has to be underpinned by solid research and analysis. Given the repeated postponement of reforms, such research is not lacking – more outside than within governmental Ministries, however, complicating its incorporation. The integration of the analysis in the design of the reforms also takes time. We note this reluctantly, well-aware of the importance of moving forward, but it is undeniable that haste often makes waste – as evident in some of the reforms undertaken in a rush by the Monti government. In complex cases (such as the labor market), it is advisable to take the time needed to be sure that one is acting diligently. This does not mean being leisurely, but does point to the need to avoid apparently easy – but analytically weak – shortcuts.

As part of avoiding delays, the OECD also notes that, while concertation may be helpful in defining reforms, it is no substitute for government leadership. Without a firmness of purpose on the part of the government, the social partners – both employers and unions – have little incentive to make concessions. Those who protest when the government exercises such leadership are in truth against any change.

Finally, OECD research, as well as other studies, also debunk an oft-repeated tenet, generally referred to as "Juncker's curse," according to which: "We [politicians] all know what to do, but we do not know how to get re-elected once we have done it." Empirically, however, the only statistically significant factor determining re-election prospects tends to be the economic cycle, with a close relationship between economic growth and the probability of re-election. To the extent that the reforms in question – along with those invoked by Italy at the European level – will help to sustain growth, so too will they pay off politically. There is here a rare "win, win" proposition, and a clear spur to action.

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