



Reform Reversal in Former Transition Economies of the European Union: Areas, Circumstances and Motivations

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ASSA Meetings, Philadelphia, PA, January 5-7 2018



Reversals are important, but under-researched

- Why focus on reform reversals?
 - Apparently wide-spread
 - No well-fitting models
 - Can be particularly damaging
- Why look into FTEs?
 - Uniquely fast-paced reforms in one generation
 - Uniquely strong role of external anchors
 - Possibly strong peer pressures, in opposing directions
- Why are they happening now?
 - Post EU accession
 - Post Crisis
 - Important episodes: role of path dependency



Slovenia: The anatomy of a major reversal episode

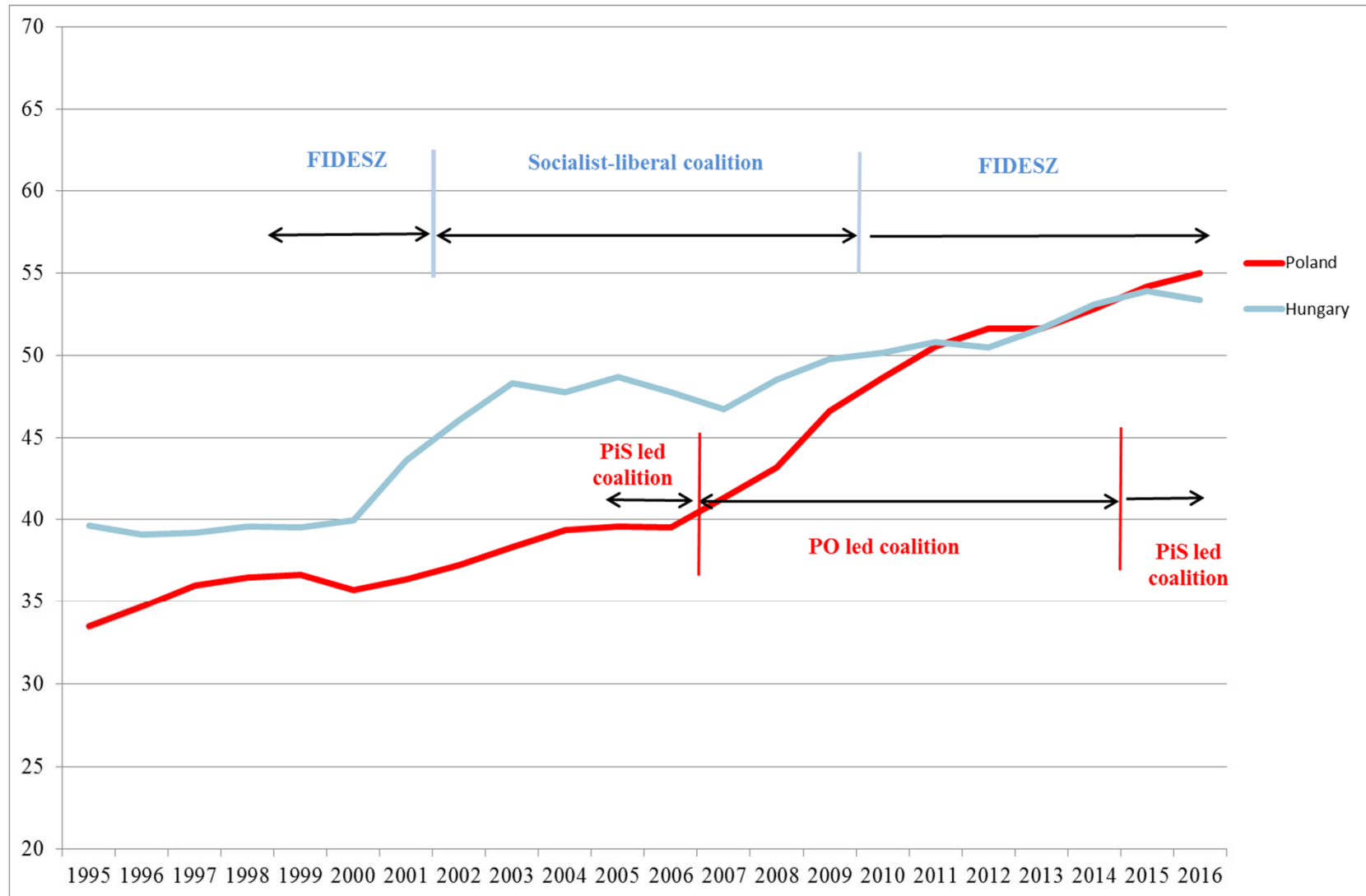


- Interplay of behavioral reversals in banking, SOEs/corporate governance and supervision
- External anchor (MIP) → Reversal of reversals: behavioral and formal (privatization)
- Spill-over → central bank independence
- Strong external anchor: ECB
- Spill-over
 - formal → behavioral
 - CB → banking

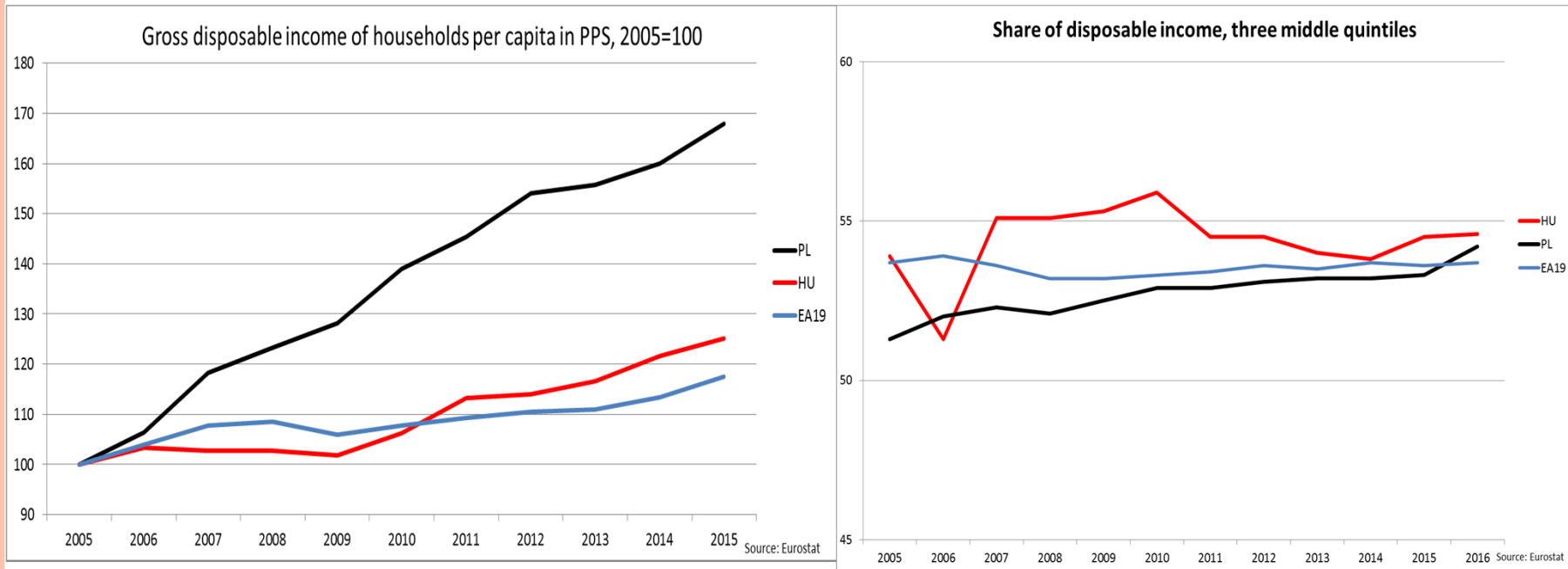


Poland and Hungary

Despite some similarities, very different episodes



Will the middle class protect reforms?



Reversals are inherent, spill-overs are central

- Rapid journeys stress-tested social learning in FTEs, leaving best-practice institutions with weak social norms
- Reversals:
 - an inherent characteristic of the reform process
 - wide-spread
 - formal (legislation) or behavioral (quality of institutions)
- Spill-overs are central:
 - formal to behavioral (and vice versa)
 - one area to another
 - one institution to another
- Major reversal episodes: interplay & spill-overs among reversals in different areas

Internal anchors remain weak

- Partial & opportunistic reversals can happen everywhere, Major & multifaceted reversals require strong governments
- Asymmetries in reversals & social norms
- Financial system: particularly prone to reversals
- Best-practice fiscal frameworks
 - not enough to anchor fiscal behavior.
 - reversals in fiscal behavior can transform into formal reversals in other areas (pensions)
- Crisis made FTEs more prone to reversals, but reversals can happen in good times too
- Other factors matter, but do not explain reversals





IMF and WB as external anchors



- Dominant anchors until EU accession started, afterwards EU gradually takes over
- (EU-) IMF programs:
 - Strong reform promoters, fending off major reversals
 - But prone to opportunistic reversals
 - Successful only up to a point
- IMF surveillance (A4):
 - Very efficient in identifying formal reversals
 - Less so regarding behavioral ones
 - Overall, a weak anchor





Strong anchor against formal reversals, but weak in preventing behavioral ones

- EU is a strong external anchor against formal reversals in areas covered by EU law, but
 - Can shift reversal efforts into other less-protected areas
 - Or transform formal reversal attempts into behavioral ones
- Weak against behavior reversals and areas not covered by EU law
 - MIP worked well when imbalances became excessive, but had weak preventive power
 - Difficult to detect behavioral reversals, especially in less transparent or legally well-protected areas – perverse behavior of independent institutions



How to strengthen internal and external anchors?

- Accelerate social learning
 - EU schemes: Erasmus+, similar for mid-career, life-long
- Focus on quality and coherence of institutions & reforms
 - SSRS: help quality & coherence & accelerate social learning
- Strengthen external surveillance, also based on an understanding of the nature of reversals & the role of spill-overs
- The political ambition ("want") of Euro area accession
 - Can spur reforms & lock in more than before (SSM)
 - But may well remain a weak anchor in other areas

