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The Political Costs of Reforms: Fear or Reality?

Gabriele Ciminelli, Davide Furceri, Jun Ge, Jonathan Ostry, and Chris Papageorgiou prepared a Staff Discussion Note examining whether the fear of a political cost associated with structural reforms is justified by the available evidence, and whether there are lessons from the data about how reform strategies might be designed to mitigate potential political costs. They find that reforms do not lead to electoral costs when implemented in a way that internalizes political economy considerations. First, because the gains of reform often take time to materialize, reforms are associated with significant electoral costs only when implemented in the runup to elections. In contrast, reforms undertaken earlier in an incumbent's term do not affect election prospects. Second, reforms have political costs when enacted in periods of weak economic activity. Third, not all types of reform are equal from an electoral perspective: reforms that engender large short-term adverse distributional effects can prove electorally costly.

Reigniting Growth in Emerging Market and Low-Income Economies: What Role for Structural Reforms?

Using a newly constructed database on structural reforms, this October WEO chapter finds that a reform push in areas such as governance, domestic and external finance, trade, and labor and product markets could deliver sizable output gains in the medium term. A comprehensive reform package might double the speed of convergence of the average emerging market and developing economy. However, reforms take several years to deliver, and some of them entail greater short-term costs when carried out in bad times; these are best implemented under favorable economic conditions. Reform gains tend to be larger when governance and access to credit are strong, and where labor market informality is higher—because reforms help reduce it. This study has been presented in outreach missions around the world, including to high-level public officials, academia, the private sector, and civil society, with coverage on the Internet, social media and the press.

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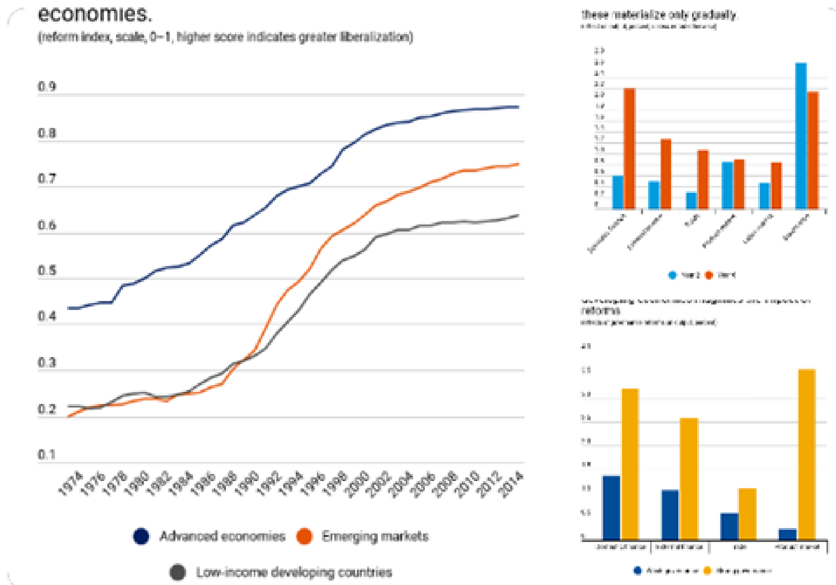

International Capital Flows, Land Conversion and Wage Inequality in Poor Countries

Conversion of land from agricultural to industrial use has been recently met with strong opposition in many developing countries. A number of relevant papers study welfare effects associated with willful conversion, no conversion or politically forced and manipulated conversion of land into other activities. No study, however, deals with the evolving skilled-unskilled wage gap consequent upon full or partial convertibility of land in the short and the long run. This study shows that in a multiple-commodity world with land as a crucial input for both agriculture and industry, an influx of capital for supporting industrial production must widen the skilled-to-unskilled wage gap. If the rate of conversion of land exceeds a critical value in the short-run, the wage gap rises. Even in the long run, possibility of full conversion can raise the wage gap if agriculture is—as is indeed the case—labor-intensive in developing countries.

Examining Structural Unemployment in Sub-Saharan Africa: Empirical Evidence from Unobserved Components

This study applies an empirical methodology to quantify structural unemployment (NAIRU), potential output, output gap and unemployment gap for South Africa, Kenya, Mauritius and Ghana. NAIRU estimates are especially relevant for these inflation-targeting or hybrid inflation-targeting economies, allowing them to assess level of domestic slack and any potential build-up of inflationary pressures. The authors suggest that increased government spending on education, a competitive exchange rate, and boosting the level of financial development (measured as the market capitalization of listed companies) can play a role in lowering NAIRU in these Sub-Saharan African countries. In addition to these main determinants, sustained gender barriers, reflected in—high female unemployment rates and low female participation rate—and higher agricultural sector growth could act as an impediment, keeping the NAIRU high, while both FDI counterpart and domestic investment are projected to exhibit a negative relationship with NAIRU.

Borrowing costs and the role of multilateral development banks: Evidence from cross-border syndicated bank lending

Cross-border bank lending is a growing source of external finance in emerging and developing countries and could play a key role in infrastructure and development financing. In this paper, Daniel Gurara, Andrea Presbitero and Miguel Sarmiento look at the role of multilateral development banks (MDBs) on the terms of syndicated loans, focusing on loan pricing. They find that MDBs' participation is associated with higher borrowing costs and longer maturities—signaling a greater willingness by MDBs to finance risky projects which may not be financed by the private sector. They also show that MDBs are more likely to lend to borrowers located in countries with high credit and financial risk. Overall, their results suggest that MDBs could play a role in easing access to credit for high risk borrowers.

Macroeconomic Outcomes in Disaster-Prone Countries

This Working Paper uses a dynamic model to study the channels through which natural disaster shocks affect macroeconomic outcomes in disaster-prone countries. Results unveil large effects of weather shocks that significantly impact the convergence path of disaster-prone countries. Relative to non-disaster-prone countries, on average, these shocks cause a welfare loss equivalent to a permanent fall in consumption of 1.6 percent. Welfare gains to countries that self-finance investments in resilient public infrastructure are found to be negligible, and international aid has to be sizable to achieve significant welfare gains. In addition, it is more cost-effective for donors to contribute to the financing of resilience before the realization of disasters, rather than disbursing aid after their realization. Giovanni Melina presented these findings at the 50th Anniversary of the MMF Conference held at the LSE in September; and at the workshop "Integrating impacts, mitigation and inequality" organized by the German Potsdam Institute for Climate Impact Research in October.

Gains from Boosting Education Outcomes in Sierra Leone

In November, during the 2019 Article IV and Second ECF (Extended Credit Facility) Review Mission to Sierra Leone, Vivian Malta presented and discussed with Sierra Leonne authorities the preliminary results of the forthcoming Selected Issues Paper on human capital formation and gender inequality. While human capital indicators for Sierra Leone have generally improved over the past two decades, both education and health outcomes lag behind most other countries. The government's National Development Plan 2019-23 targets substantially boosting human capital, including through the Free Quality Education for All program. The presentation shows that the gains from providing each child with at least lower secondary education could, in the long-term, boost GDP by 40 percent, substantially lower income inequality, and generate additional revenues through higher individual incomes. Separately, closing gender gaps in education across income groups or increasing the quality of education could yield gains of 8 and 27 percent of GDP, respectively.

High level policy conference: Making the Case for Reform

While there is broad agreement on the economic benefits of structural reforms, they often carry short-term costs while most of the economic gains from reforms only materialize over the longer term. On this background, a panel at 2019 IMF-World Bank Annual Meetings discussed the political economy of reform and the challenges with implementing structural reforms. Key takeaways from the event covered: (i) reform priorities: While panelists agreed that the goal is to achieve sustainable growth, there were different views on reform priorities; (ii) reform implementation: Timing, allocation of benefits, as well as the public narrative are important considerations in reform implementation; and (iii) political-economy challenges: Panelists noted the challenges associated with the political process in approving reforms, highlighting possible electoral costs to the incumbent.

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@Lipton_IMF: The timing of reforms is important. Some reforms, such as those in labor markets and domestic finance, pay higher growth dividends if implemented when the economy is strong. #StructuralReforms #PoliciesForGrowth ow.ly/DySu50wOEak

Financial Deepening, Terms of Trade Shocks, and Growth Volatility in Low-Income Countries

On November 18, Roland Kpodar presented their findings at a seminar organized by the Graduate Institute of Geneva (IHEID). The paper argues that banking sector development acts as a shock-absorber in poor countries, dampening the transmission of terms of trade shocks to growth volatility, although this role fades away as economies grow richer. In contrast, stock market development appears to be neither a shock-absorber nor a shock-amplifier for most economies. These results highlight the importance of financial structure for growth volatility, thus contrasting with the conventional wisdom that financial structure does not matter for growth. The presentation generated a lively discussion, with suggestions ranging from narrowing down the analysis to commodity exporters to exploring the role of foreign ownership of banks in strengthening a country’s resilience to shocks.

For more information, please contact MacroResDev@imf.org.
See IMF-DFID Macroeconomic Research for Development website for further details on the project.