

**General Secretariat
GROUP ON REGULATORY POLICY**

Interlinking Market Openness Policies in a Friendly Reform Environment: Lessons from Trade and Structural Adjustment

**3-4 December 2007
OECD Headquarters**

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JT03235730

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ACRONYMS AND ABBREVIATIONS

ALMP	Active Labour market Policy
APHIS	USDA Animal Plant Health Inspection Service
APPE	Association of Petrochemical Producer in Europe
BPS	Business Process Services
CSO	Civil Society Organisation
CTHA	Chemical Tariff Harmonising Agreement
FDI	Foreign Direct Investment
ITS	Information Technology Services
ICT	Information and Communications Technology
JLSV	Local Phytosanitary Control Boards (in Mexico)
NAFTA	North American Free Trade Agreements
RIA	Regulatory Impact Analysis
RTA	Regional Trade Agreements
SPS	Sanitary and Phyto-sanitary
TAA	Trade Adjustment Act
TPA	Trade Promotion Authority
USDA	United States Department of Agriculture

INTRODUCTION

1. This paper explores the theme of market openness and the political economy of reform, building upon previous OECD work addressing trade and structural adjustment. The two questions this paper will seek to address include how to make the case for trade liberalisation and market openness *vis-à-vis* domestic economies, and how to bring domestic constituencies aboard to ensure sustainable reform. The paper selectively presents and analyses findings, data and information contained in the publication *Trade and Structural Adjustment: Embracing Globalisation* (OECD, 2005), and in two Trade Policy Working Papers including “Facilitating Adjustment: Sector Experiences from Agriculture, Telecommunications and Chemicals” [TD/TC/WP(2006)11/FINAL] and “Facilitating Trade and Structural Adjustment: Experiences in Non-member Economies”, [TAD/TC/WP(2007)6PART1]. The paper goes one step further by addressing how policy makers can pro-actively harness the information and analysis contained in previous works to more effectively elicit support from domestic constituencies for market opening reforms and to sustain domestic regulatory reform processes.

2. This paper will review the experiences of economies that have successfully managed structural adjustment. It seeks to distil useful insights for policy makers charged with promoting market opening reforms and with sustaining reform over time, particularly where such reforms are themselves likely to catalyse structural adjustment. This subject will be addressed under three headings:

- how policy makers can prepare in advance of market opening reforms;
- how they can make the case for market opening reforms;
- and how they can conduct reform in a manner that sustains support from domestic constituencies.

3. The conclusion of this study will also provide suggestions on areas where further research would deepen knowledge of how domestic constituencies may be “brought on board” to support market opening regulatory reforms and to sustain reform processes.

The elements of planning for market opening regulatory reforms

4. The topic of how to make the case *vis-à-vis* domestic constituencies for initiating and sustaining market opening regulatory reform, encompasses not only the economic and regulatory aspects of the reform process, but also the political economy aspects related to addressing the interests of various stakeholders including those to be negatively or positively impacted. Case studies reviewed under OECD work on trade and structural adjustment underline the importance of having well functioning domestic institutions in place to meet the challenges of structural adjustment. Having an effective regulatory system also allows for more reliable assessments of the nature of anticipated benefits from new market opening reforms. Such assessments should map the constituencies that will benefit or lose from market opening reforms. With such information, market opening reform “packages” can be designed to draw attention to the net benefits of reform to the domestic economy and, where possible, to provide constituencies anticipating negative impacts with offsetting benefits from other elements in a wider reform package.

Beginning with the basics: effective institutions and open domestic regulatory environments

5. Depending on their scope, nature and quality, domestic regulations may facilitate or hinder structural adjustment. Good practice distilled from the case studies on trade and structural adjustment consistently highlights the reliance of successful structural adjustment on a number of policy areas. These policy areas, which will influence structural adjustment to varying degrees, include:

- **Macroeconomic policies** which promote stability and growth;
- **Labour market policies** which help develop human skills and which facilitate a smooth transfer of resources from declining to expanding activities, while providing adequate assistance to those who experience adjustment costs as a result of structural change;
- **An efficient regulatory framework**, that keeps regulatory burdens on enterprises to the necessary minimum, fosters competition and helps ensure genuine market openness;
- **A strong institutional and governance framework** that will favour structural reform, while also enhancing public understanding and acceptance of reform measures; and
- **Liberal trade and investment policies** which support structural adjustment by contributing to growth, innovation and competitiveness and which are implemented over a period gradual enough to enable affected parties to adapt and short enough to avoid policy reversal. Should it be considered necessary to use safeguard measures, this should be on the basis of analysis as to whether their potential benefit in providing breathing space for – and public acceptance of – structural adjustment exceeds the costs they entail.¹

6. Among these policy areas, effective labour market policy is key to facilitate structural adjustment, and to mitigate resistance from domestic constituencies negatively impacted by market opening reforms. This is particularly so where a “considerable share of the workforce in OECD economies experiences an involuntary layoff and that a significant minority of these workers suffers long unemployment spells and/or sizeable earnings losses”.² In assessing the impacts of market opening reforms, policy makers should consider that even among OECD countries, broad variations exist in terms of domestic regulatory frameworks to facilitate the labour related aspects of structural adjustment.³ Having in place effective active labour market policies (ALMPs – *i.e.*, regulatory frameworks for job-search assistance, counselling, training, moving allowances and other reemployment services), significantly enhances the ability of economies to adapt to structural adjustment, and will tend to reduce resistance to reform. Reinforcing them would be a useful initial step to addressing the constituencies likely to be negatively impacted by market opening reforms.

7. On the other hand, insights accumulated over a decade conducting OECD country reviews of regulatory reform, particularly their chapters addressing market openness, provide a well established basis for assessing the extent to which market opening regulatory reforms will be met by efficient structural adjustment and anticipated economic benefits. These insights strongly suggest that domestic regulatory regimes with high degrees of “market openness” will increase economic benefits from “market opening” reforms.

8. Policy makers considering market opening reforms are encouraged to assess the degree of market openness reflected in a national regulatory regime based on the six principles of market openness (see Box 1) that have been developed and refined over the course of numerous country reviews of regulatory reform. These six principles provide a tested regulatory instrument for assessing the degree to which national regulatory institutions and practices – including those not directly related to trade – are impacting the

capacity of economies to benefit *de facto* from *de jure* liberalisation commitments under trade and investment, whether under the WTO or other international agreements. Deficiencies in market openness will hamper the ability of economies to benefit from existing market liberalisation commitments. Conversely, a high degree of market openness will support the ability of economies to benefit from interactions with the international economy at any level of liberalisation. It will furthermore supplement the capacity of economies to benefit from new market opening regulatory reforms, notably those under the WTO.

Box 1. The OECD Efficient Regulation Principles for Market Openness

To ensure that regulations do not contradict and reduce market openness, “efficient regulation” principles should be built into the domestic regulatory process and practices. These principles have been identified by trade policy makers as key to market-oriented trade and investment-friendly regulations. They reflect the basic principles underpinning the multilateral trading system.

Transparency and openness of decision making: Foreign firms, individuals and investors seeking access to a market must have adequate information on new and revised regulations so that they can base their decisions on accurate assessment of potential costs, risks and market opportunities.

Non-discrimination: Non-discrimination means equality of competitive opportunities between like products and services irrespective of country of origin.

Avoidance of unnecessary trade restrictiveness: Governments should use regulation that are not more trade restrictive than necessary to fulfill legitimate objectives.

Use of internationally harmonised measures: Compliance with different standards and regulations for like products can burden firms engaged in international trade with significant costs. When appropriate and feasible, internationally harmonised measures should be used as the basis of domestic regulations.

Streamlining conformity assessment procedures: When internationally harmonised measures are not possible, necessary or desirable, the negative effects of cross-country disparities in regulations and duplicative conformity assessment systems can be reduced by recognising the equivalence of trading partners’ regulatory measures or the results of conformity assessment performed in other countries.

Application of competition principles: Market access can be reduced by regulatory action ignoring anti-competitive conduct or by failure to correct anti-competitive practices.

Source: OECD (2002), “Integrating Market Openness into the Regulatory Process: Emerging Patterns in OECD countries” [TD/TC/WP(2002)25/FINAL], 17 February 2003.

Facilitating acceptance of change: perceptive planning

9. Whether or not supported by specific policy measures, structural adjustment is the process of transfer of resources from declining to expanding activities. Thus there are always winners and losers. Winners are often more dispersed than losers who are usually more concentrated. Thus the difficulty in advancing reforms and the need for considering the political dimension of reform.

10. OECD country reviews of regulatory reform underline the benefits of conducting regulatory impact analysis (RIA) prior to reform in order to better understand the contours of benefits and costs that regulatory reforms under consideration are likely to bring. Consistent use of RIA improves the design of reforms and serves to prevent the implementation of reforms with unintended negative impacts, thus enhancing the efficiency of regulatory regimes overall.

11. When considering market opening regulatory reforms in particular, RIAs, or alternative regulatory instruments serving impact assessment purposes, should also be adapted to assess how the constellation of domestic constituencies will be impacted by reforms. Such assessments should also detail the relative magnitudes of economic impacts that the respective constituencies are expected to face, whether positive or negative. Knowing in advance which constituencies are likely to support or oppose reform – and the vigour with which they are likely to engage the reform process – is an important first step in designing and implementing market opening reform processes which are disproportionately subject to political economy factors.

Facilitating acceptance of change: strategic bundling

12. Knowledge of the domestic constituencies that will be positively and negatively impacted by market opening regulatory reforms allows for more strategic “bundling” of reform packages. Bundling would ideally provide those losing from market opening reforms with offsetting benefits from other elements of an overall reform package. Indeed, multiple case studies reviewed in OECD work on trade and structural adjustment demonstrates that bundling reforms can facilitate structural adjustment. The case studies furthermore find that pursuing reforms across policy areas in a co-ordinated manner reduces resistance to reform and increases the likelihood that constituencies disadvantaged by reforms in one area, would have opportunities to benefit from reforms in another.⁴ The case of South African automobile industry demonstrates how market opening reforms supported by a package of complementary measures not only fostered an international competitive automobile parts industry, but harnessed foreign direct investment (FDI) to support of the adjustment process (see Box 2).

Box 2. Trade and trade policies: helping adjustment (I)

Improving access to essential inputs: South African autos

Trade policy in relation to the automobile industry in South Africa has evolved over time, moving from simple protectionism beginning in the 1920s, import substitution characterised by local content requirements beginning in the 1960s, and two periods of reform and liberalisation since the 1980s.

In 1989, South African trade policy applying to the auto industry was reformed to enhance international competition through trade liberalisation and increased access to the essential inputs. The new policy of “import-export complementation” was designed to create incentives for competitiveness while ameliorating anti-export biases created by measures originally designed to protect the domestic auto industry. Doing away with mandated local content requirements, the new trade policy regime substituted a system allowing auto producers to receive credits for auto components and vehicle exports that could be applied against duties on imported auto components.

These reforms enabled the auto industry to specialise in producing auto components and vehicles that were internationally competitive by facilitating the incorporation of key auto components that could not be efficiently produced domestically. Significantly, these reforms also stimulated foreign investment in domestic auto component manufacturing which further supplemented the competitiveness of both the domestic auto component and vehicle industries.

Source: OECD (2005), p. 109.

13. In some sectors, market opening reforms should be bundled with measures to improve or establish regulatory institutions. This is because market opening reforms in the absence of effective regulatory institutions can result in situations of decreased service provision and/or lower quality of service. Case studies related to trade and structural adjustment suggest that attention to sequencing reforms, in particular by establishing effective regulatory institutions in parallel or prior to liberalisation, has in some sectors been an important factor of success.⁵ This observation is particularly evident in the case of public services such as telecommunications. Without effective competition policy regimes, market

opening reforms can lead incumbents to exercise market power and thus stymie the entry by new service providers, including foreign ones that could bring FDI in support of adjustment and enhanced economic performance.⁶

14. The case studies also underscore that more emphasis on building institutions as well as human and physical capital can generate considerable benefits for developing countries.⁷ A number of case studies on liberalisation in the telecommunications sectors of developing countries show how market opening reforms in this sector has supported adjustment and economic performance in others (see Box 3). Such case studies also reinforce the importance of investing in human capital as a prerequisite for accessing benefits of market opening reforms.

Box 3. Telecommunications services and export opportunities for developing countries

Reliable telecommunications services and FDI friendly policies have helped create new export industries in labour intensive and capital scarce countries with well trained graduates. The Indian IT services (ITS) and business process services (BPS) industry delivers services through ICT networks – which initially were special cable networks connecting major IT hubs – and currently employ more than one million workers (Nasscom, 2005). In the year ending March 2005, India exported USD 17.2 billion worth of ITS and BPS. The Philippines is another developing country which is quickly establishing itself as a global champion of voice-based BPS. In 2005, figures from the Philippine government indicated that the supply of ITS and BPS was worth USD 2 billion and the industry employed around 100 000 call centre workers. The country's early and complete liberalisation of the telecommunication sector translated into a competitive advantage in providing these services as investment in telecommunications equipment improved quality and competition drastically reduced prices (OECD, 2006).

These new industries are entirely dependent on reliable and cost-effective supply of telecommunications services. But India and the Philippines would not have managed to take advantage of the opportunity if it was not for their investment in tertiary education. OECD (1995) emphasised more than a decade ago that the developments in the telecommunications market would have implications for government policy in education and training not only to provide the necessary skills for their PTOs to compete in global markets, but also to satisfy the increasing need for ICT skills across the economy. These recommendations were mainly targeted to OECD countries. However, as the Indian and Philippine cases show, they are just as relevant for developing countries.

Source: OECD (2006), p. 87.

Efficiency and equality considerations: the flat tax

15. Equity concerns are also an important consideration when designing reform bundles. From this point of view, flat tariffs have been found advantageous in comparison to differentiated tariffs. While the difficulty to reconcile “first best” policy reforms with political economy challenges, often results in adopting “second best” policies, a flat tariff could be an exception, in that it can be a “first best” policy approach that is also supported by political economy considerations. From an economic perspective, a flat tariff is preferable as it minimises distortions in price signals for imported goods, thus allowing for domestic economic actors to select the most efficient mix of imports in production decisions. Political economy considerations supporting the flat tariff include the reduction of incentives for lobbying by domestic constituencies as all constituencies favouring higher levels of protection can “free ride” on the individual resource expenditures of those engaged in lobbying.⁸ From a regulatory perspective, flat tariffs greatly reduce administrative burdens as they eliminate incentives to misclassify good in order to benefit from differentiated tariff rates.⁹ Shifting from a differentiated system of tariffs to a flat tariff is itself, however, a significant political economy challenge. Only Chile among the countries reviewed in OECD structural adjustment work has such a system in place.¹⁰

Making the case for market opening regulatory reforms

16. A number of factors contribute to making a case for market opening reforms *vis-à-vis* the domestic economy. Much hinges on the credibility of the reformers as well as that of the reforms themselves. In this section, a number of approaches and considerations are explored regarding how to meet the political economy challenge presented by domestic constituencies that stand to lose from market opening reforms, even when such reforms would benefit the economy overall. The substantive case for market opening regulatory reforms is reinforced by the unambiguous findings of the reviewed works on trade and structural adjustment that it is the evolving global economy and not trade liberalisation *per se*, that primarily generates the need for structural adjustment. As evidence was found that this situation is likely to persist well into the foreseeable future, economies may more strategically contemplate market opening reforms based not on what structural adjustment they in isolation will entail, but on how such reforms can enhance their capacity to benefit from the advancing global economy.

The importance of credibility: harnessing political support to market opening regulatory reforms

17. The credibility of policy makers making a case for market opening reforms can be considered in two aspects. How credible are the reformers and how credible is the reform package? When judging the credibility of policy makers making a case for market opening regulatory reforms, domestic constituencies are likely to rely on experience with the extent to which previous market openings have yielded tangible benefits. The quality of market openness reflected in a domestic regulatory regime will have significant implications for policy makers seeking to make the case for market opening regulatory reforms *vis-à-vis* the domestic economy. If benefits expected from market opening reforms had materialised in previous instances, domestic constituencies will be more favourable when policy makers seek support for new ones. Maintaining an ongoing programme of regulatory reform generally and paying specific attention to market openness principles in the process, strengthens the credibility of reformers seeking to make the case for new market opening reforms.

18. The case for market opening reforms is more credible when bundled with complementary reforms, and credibility can be furthermore strengthened in a number of ways.¹¹ First, designing packages of deeper reforms contributes to overall credibility. Second, attention should be paid to ensuring that reform packages consist of mutually supporting and consistent policies. This is because mutually complementary policies increase the cost of reversing one single part of the policy package. Third, use of international commitments provides a relatively easy way to gain credibility. For example, Ecuador enhanced the credibility of its second reform effort by relying on the Andean Community and WTO accession,¹² which led to a better consolidation of economic benefits despite past failed attempts at trade reform.¹³ However, caution is necessary as overt reliance on international commitments might backfire and lead to a loss of ownership of reforms.

Transparency and dialogue with constituencies lends credibility and may enhance the quality of reforms

19. Dialogue with the private sector and civil society is a key element and a potential source of credibility by policy makers seeking to gain support for market opening regulatory reforms. Governments and international as well as national industry associations may furthermore play a constructive role supplementing information and analysis on the implications of structural trends within an industry/country. Likewise, providing firms and workers with better information and an active role in the reform process can allow them to better adapt to the changing environment and thus enhance their support both before and during the reform process.

20. The benefits of government dialogue with industries facing structural adjustment whether due to the changing global economy or proposed market opening reforms were demonstrated throughout the process of planning for reforms in the United States tobacco industry.¹⁴ In this instance, policy dialogue facilitated the credibility of reforms¹⁵ that oversaw a decline in the number of tobacco farms by 85%

between 1965 and 2002. In the case of the EU chemicals sector, EU policy makers similarly enhanced the credibility and quality of reforms through consultations with the Association of Petrochemical Producers in Europe (APPE), which provided valuable benchmarking data on capacity and production trends.¹⁶ In both of these instances and others, government effort to alert the industry and workers of structural change, and to facilitate a better understanding of markets, enhanced the credibility, legitimacy and effectiveness of the reforms and their performance.

21. In a related case, attempts by Chile to engage trade reform in the 1970s and again in the early 1980s ended in reversals, but the credibility of its second wave of reforms undertaken in the late 1980s was reinforced by dialogue with the private sector. In this instance, dialogue served to improve both the policy formulation process and the coherence of the final package.¹⁷ The case of the Brazilian tobacco industry demonstrates that advocating and implementing regulatory reforms to facilitate structural adjustment can be assisted not only by government dialogue with private sector, but also through active participation by civil society organisations (CSOs). Substantive input from major tobacco companies, producers association and a university supported the ability of the local tobacco industry to increase output by an average of 3.5% from the 1980s to the 2000s.¹⁸

Governments may need to compensate losers: specific timelines and caution in setting precedents

22. Measures to address adjustment costs, should to the extent possible rely on generally applicable policies such as tax and social security. Adherence to this principle serves to avoid creating new distortions in the economy that would themselves require future regulatory reforms. However, where market opening reforms entail particularly concentrated adjustment costs on specific sectors or geographic areas, affected constituencies are likely to be highly vocal opponents of reform. Although reliance on generally applicable policies should be preferred as a general rule, such instances may warrant specific policies to ameliorate the cost of adjustment. Small vocal constituencies seeking to block market opening regulatory reforms often face disproportionate costs from such reforms. Providing sector or geographically specific policies to ease the cost of adjustment may be the only means of securing the larger benefits from market opening reforms under such circumstances. The case of the structural adjustment in the Austrian steel sector highlights a case when the concentrated geographic impact of structural adjustment resulting from regulatory reforms was judged to warrant targeted policies. This case also reinforces the benefits of engaging public-private dialogue to facilitate the process of adjustment (see Box 4).

Box 4. Targeted labour market programmes involving both the private and public sector

The resilience of communities heavily dependent on single industries can be assisted by measures taken in co-operation between the public and private sectors to facilitate transition. In the late 1980s, privatisation of the underperforming **Austrian steel industry** led to significant layoffs in this sector. As part of a social plan to help cope with the negative aspects of structural reform, management and the works council negotiations brought about the creation of the Austrian Steel Foundation. The Foundation's shared responsibility for labour market adjustment is reflected in its executive board, which consists of three works council members and three steel firm managers. The Foundation provides services tailored to individual worker needs and includes vocational orientation, small business start-up assistance, rigorous and extensive training or formal education (sometimes for several years) and job-search assistance. Retraining programmes are concentrated on re-qualification and occupational reorientation rather than on marginal skill upgrades. The Foundation is financed by the steel firms and programme participants themselves, as well as by the government (in the form of unemployment benefits) and remaining employees who pay a solidarity levy of 0.25% of gross wages toward the Foundation.

Evaluations have suggested positive results. One rigorous evaluation suggests that, in the five years following completion of the Foundation's programme, employment prospects were significantly higher for participants than non-participants. Younger participants and low-wage workers also achieved significant wage gains compared to the control group. There is little in the way of evidence, however, to suggest whether the positive results associated with this employment foundation are the result of unique characteristics of this effort or whether its structure could be duplicated or generalised. Also, participation rates among eligible workers have been relatively low.

Source: Adapted from OECD (2005), p. 102-104.

23. In some cases, the realities of political economy surrounding the sensitive issue of market opening reforms make targeted policies to address resistance to reform by workers facing job loss unavoidable. The benefits of market opening would be inaccessible absent a targeted package of reforms. Probably the most well known example is that of the United States Trade Adjustment Act (TAA) which provides preferential benefits to workers that have lost their jobs due to trade liberalisation. Although granting preferential benefits to workers that have lost their jobs as a result of market opening as opposed to other causes raises equity related concerns, implementation of the TAA has in practice encountered difficulties in distinguishing between workers made redundant by market openings as opposed to other causes. A similar programme described in an Australian study suggests such targeted programmes should be avoided when possible (see Box 5).

Box 5. Targeted nation-wide labour market programmes

Adopted in 1962, the **United States Trade Adjustment Assistance (TAA)** legislation complements general unemployment assistance and ALMPs by providing temporary assistance to workers losing their jobs as a result of trade liberalisation. The economic rationale for this policy remains controversial, since it is not evident that trade-displaced workers should receive more adjustment assistance than other job losers encountering similar difficulties and, in any case, it has proven difficult to differentiate between the two groups of job losers. Nonetheless, the TAA programme has been a source of innovative practices related to the provision of earnings-replacement benefits (e.g., the wage insurance programme introduced in 2003) and training for displaced workers (e.g., voucher programmes operating through state community college systems).

On the other hand, TAA seems to respond well to political economy considerations, in particular by consolidating public support for trade liberalisation. TAA has been significant in the area of textiles which accounted for 35% of all TAA certifications between 1995-2000. The Trade Act of 2002, which established the current system of Trade Promotion Authority (TPA) that facilitates acceptance of trade liberalisation by the US by restricting the power of Congress to alter trade agreements negotiated by the President, also contains substantial enhancements to existing TAA for workers displaced as a result of international trade agreements.

The **Australian Structural Adjustment Assistance programme**, initiated in 1973 following significant tariff cuts, was targeted specifically to trade-displaced workers. The programme, which focussed on income assistance rather than active measures, was terminated in 1976 after only three years. Its termination came on the heels of a government evaluation which concluded that the provision of special benefits to designated displaced workers reduced worker mobility. Other reasons for ending the programme included pressures on government to provide similar benefits to other displaced workers and the arbitrariness of the determination that recipients are unemployed as a result of government policies. The programme was similar to the early TAA programme in the United States in its emphasis on passive measures and disappointing evaluation results.

Source: Adapted from OECD (2005), pp. 102-4.

24. As alluded to above, the primary concern with targeted policies is that they create expectations among losers from reforms that compensation should be granted as a standard practice. Such expectations create incentives to stand against reform as a general rule, which will serve to make future reforms more difficult. Targeted policies also raise the issue of equity, as indicated in the case of TAA in the United States.

Uninterrupted structural adjustment: the rate of change has not increased for decades

25. Reform is not the only trigger of structural adjustment, while it can facilitate structural adjustment whatever the cause. The underlying theme of OECD (2005) is that the primary factors driving structural adjustment include new sources of competition, technological change and associated reductions in transport and communication costs, and shifting consumer preferences and societal concerns. The study finds that (although perceptions may be to the contrary), the rate of adjustment has not increased over the past two decades.

26. Although international trade and investment serve as the conduit between the changing global economy and domestic structural adjustment challenges, the various studies of structural adjustment cases show that trade related structural adjustment is driven predominantly by factors unrelated to market opening regulatory reforms. The continuing processes of structural adjustment resulting from the evolution of the international economy entail sustained regulatory reforms that are independent of new market opening reforms. As a result, the need for sustained structural reform strengthens the case for market opening reforms designed to facilitate structural adjustment and to enhance the ability of economies to benefit from globalisation.

27. Structural adjustment has not accelerated over the last two decades in the OECD area.¹⁹ Indeed, structural adjustment within the OECD area is not only an ongoing process, research indicates that rates of change in sectoral employment patterns are actually relatively stable. What has changed is that labour adjustments between agriculture (and other primary industries), manufacturing and services have declined. As shifts of employment from goods-producing sectors to services have slowed, structural changes in employment patterns will increasingly take place between broad industries within the service sector. The increasing exposure of new services sectors to international competition has occurred largely independently of market opening reforms. It is for this reason that this pattern will likely continue for the foreseeable future. Case studies of successful trade and structural adjustment suggest that processes of domestic regulatory reform, including those entailing market openings, are the primary source of improved competitiveness in domestic services sectors. The most effective reforms will seek to leverage the benefits of foreign trade and investment.

28. Domestic constituencies are more likely to accept regulatory reforms for market openings under circumstances where structural reform is itself seen as unavoidable and independent of trade and investment liberalisation. The case is further strengthened where such market opening reforms serve to alleviate the costs of adjustment by accelerating the movement of productive resources into sectors that they fortify *via* increased economic efficiency. In some instances, pressures for market opening regulatory reforms may even emanate from domestic sources of structural adjustment. The case of Japan highlights how market opening regulatory reforms could be leveraged to meet domestic structural adjustments processes unrelated to developments in the international economy. In this instance, it is domestic structural adjustment challenges that are propelling efforts to enhance market opening regulatory reforms (see Box 6).

Box 6. Japan-Thailand/Philippines: domestic structural adjustment challenges in support of market opening regulatory reforms

By 2020, the ratio of working aged adults to senior citizens in Japan will drop from the current 4:1 to nearly 2:1 thus shrinking the tax base financing public services while increasing demands on the healthcare system. Ageing in Japan is the primary driver of structural change in the Japanese healthcare sector; policy makers are seeking to address it, in part, through regional trade agreements (RTAs) that facilitate trade in health services. Fostering trade in healthcare services through better bilateral co-ordination of regulatory institutions to allow for trade in healthcare services e.g., by developing mutual recognition systems enabling healthcare providers to provide services in foreign healthcare systems, can be facilitated by market opening reforms *via* RTAs. Conversely, domestic structural adjustment challenges can support innovative domestic regulatory reforms process which allow for *de facto* market openings, e.g., via portability of healthcare insurance which currently restricts mode 2 trade or movement of patients to healthcare providers abroad. Efforts to better enable Japanese senior citizens to receive retirement home care in destinations including the Philippines and Thailand (thus reducing strains on the domestic system), demonstrate how structural adjustment challenges can initiate domestic regulatory reform processes that can support market opening reforms.

Source: Adapted from OECD (2005), p. 117.

29. The case of the Australian shipbuilding industry showcases market opening reforms accompanied by a range of concomitant measures to facilitate adjustment and to enhance competitiveness. This case study highlights how even traditional industries can benefit from liberalising reforms, when provided with well designed bundles of complementary reform measures (see Box 7).

Box 7. Trade and trade policies: helping adjustment (II)

Stimulating exports: Australian shipbuilding

The system of government support to the Australian shipbuilding industry, dating back to 1940, consisted of “bounties” in the form of subsidies provided to offset the higher cost of domestic ship production when compared to that in the United Kingdom. Applicable only to ships bound for domestic use, this system discouraged investment, innovation and diversification of production away from large steel hulled vessels, which were increasingly being produced with more technological sophistication and at a lower cost by European and East Asian shipbuilders in the 1970s. Thereafter, a series of reforms to the Australian shipbuilding subsidy regime resulted in its complete removal by 2003. The effect was a reduction in the number of people employed in the Australian shipbuilding industry by nearly half (to 7434) between 1985 and 1996, and a three-fold increase in the output of the domestic shipbuilding industry over the same period. The vast majority of current production is now destined for export.

First revamped in the 1970s, the system of subsidies applied to the shipbuilding industry was recalibrated to support structural adjustment for long-term growth, export competitiveness and thus eventual phase out. Moving away from a cost-based approach to calculating subsidy amounts, to remove disincentives for efficiency and innovation, the nominal rate of assistance was also gradually tapered from 27.5 to 0 per cent between the early 1980s and 2003. Building on efficiency and technological advancement as criteria for receiving benefits under the new scheme and allowing for *exported* vessels to receive benefits in 1984 focused the domestic shipbuilding industry on developing a niche in which it would be internationally competitive. The result of these policies was a conversion of the domestic shipbuilding industry from one based on large steel hulled ships – already produced more efficiently by international competitors to technologically cutting edge fast ferries for which there were few viable international competitors.

Source: OECD (2005), p. 109.

Managing market opening reforms

30. Previous experiences with market opening reforms provide an important basis for policy makers when considering how best to sustain support from domestic constituents behind new reforms. Likewise, domestic constituencies will consider past experiences when deciding on the level of political support to provide. Once reforms are under way, however, maintaining support from constituencies will be strongly conditioned by the quality of export response they generate. Locking in reforms through international commitments can also enhance the sustainability of reform by increasing regulatory certainty, which facilitates the transfer of economic resources into export sectors. And participation in multilateral process of liberalisations can have the added benefit of promoting best practices and thus virtuous processes of interaction between international negotiations and domestic reform efforts. Regular interaction at various levels of reform can increase coherence and thus facilitate the economic benefits that sustain support from constituencies.

Public support for sustained reform: seeking for export responses

31. Smooth structural adjustment is important in maintaining support for reforms. It is only by ensuring that there will be winners at an early stage of reforms that reforms can be sustained. This is because the losers from reform will always try to overturn the reform. In the case of trade reform, the winners are exporters – thus export response is key in maintaining support for trade reform, and lack of export response has been one of the main causes for reversals. Once market opening reforms are initiated, efforts to sustain support for continuing the reform process will be increasingly linked to the quality of export response experienced. However, there may be a time lag before a noticeable export response.

32. In practice, export response can be slow for a number of reasons including: distortions in price signals, deficiencies in policy credibility, and various constraints faced by exporters such as lack of access to competitively priced inputs, technology, labour, financing and information. Active efforts by the government to facilitate supply response through well designed policies that encourage exports, will increase the attractiveness of continued reform in the eyes of domestic constituencies. Such policies can include ensuring access to competitively priced inputs, which is now a prerequisite in an increasingly competitive global market. Others may include tariff exemptions on inputs for exports, duty drawbacks, export processing zones and other mechanisms, which have been used with success in a number of cases. Thailand's duty drawback has for instance been used effectively to reduce the anti-export bias in its trade regime.²⁰ The importance of a generally liberal regulatory environment is underlined by the fact that this system had become increasingly complex to administer, particularly in comparison to more straightforward approaches such as reliance on a flat tax.²¹

33. Because information on export markets and technology can be expensive for individual exporters to acquire, governments can play an important role by acting as a clearinghouse for information related to export. It can assemble and disseminate such information for national exporters as a whole thereby lifting the competitiveness of the export sector overall. Further means by which to facilitate export response can include providing assistance for companies interested in reorienting towards foreign markets *via* activities to enhance the reputation of domestic exporters abroad, and/or organising exporters to undertake such efforts collectively.

34. Governments should nonetheless not lose sight of sustaining efforts to continuously improve the efficiency and openness of the overall domestic regulatory framework throughout the market opening reform process. The case study of Infosys demonstrates how improving the openness of the domestic regulatory environment can be the key factor in enabling the private sector to take the lead (see Box 8), and thereby sustain the strong export responses which attract support for continued reform.

Box 8. Trade and trade policies: helping adjustment (III)

Fostering competitiveness and innovation: Infosys Technologies Ltd

The case of Infosys demonstrates how openness in trade and trade policies can stimulate competitiveness and innovation. In 1991, India initiated a reform agenda to open its economy to increased trade and investment. As a result, companies such as British Airways and General Electric established IT centres and back offices in India to service English speaking markets on a global basis. Transfer of technology to establish these operations left India with a pool of IT talent which provided a basis for investment and further knowledge transfers by ethnic Indian IT professionals, particularly from the US. Established under such circumstances, Infosys stands out among the innovative, competitive and independent companies based in India and servicing clientele around the world.

Recording 800% growth over the last five years, Infosys now manages projects and provides services from a variety of locations throughout the world. Its success was assisted by three factors signalling the benefits of a liberal trade environment and supportive policies in ancillary sectors. First, the development of Infosys was aided by the easing of the legacy of protectionism and state planning characteristic of the Indian regulatory environment. Second, developing without a domestic client base meant that Infosys, as measured by its competitiveness *vis-à-vis* established foreign providers in foreign markets, had to be efficient from the onset by adopting an innovative delivery model based on new IT technologies. Finally, the large pool of skilled labour in India and the fact that IT services companies rely disproportionately on a well educated work force, rather than physical infrastructure, provided natural synergies between needs and resources.

Source: OECD (2005), p. 109.

Internationalising domestic processes of reform: locking out regulatory uncertainty and anchoring best practices

35. Trade liberalisation can facilitate reforms by providing new markets. Multilateral trade liberalisation may provide potential new markets which can facilitate the domestic reform process. International commitments can be used to “lock in” reforms and promote good practices. However, too much reliance on external pressure, such as that of international financial institutions, to achieve reforms can backfire.

36. Multilateral/plurilateral commitments contribute to establishing an enabling environment by locking in trade and investment liberalisation and thereby reducing regulatory uncertainty. Such an approach enhances the confidence of private actors to make larger investments with longer time horizons. Indeed, such commitments may themselves trigger economic reforms and thus further clarify a blueprint for future reforms. As multilateral and plurilateral rulemaking tends to promote good regulatory practice, commitments to adhere to them can be a powerful basis for catalysing and sustaining domestic reforms in participating countries. The case of the Chemical Tariff Harmonising Agreement (CTHA) recounts how synergies between international negotiations and domestic liberalisation can achieve market opening outcomes that would not be possible when pursued by individual economies (see Box 9).

Box 9. The Chemical Tariff Harmonisation Agreement

As a part of the Uruguay Round, a group of WTO Members agreed to harmonise tariffs on a broad range of chemical goods to promote liberalisation in the chemical sector and to develop a more predictable and transparent global tariff structure. The result was the Chemical Tariff Harmonisation Agreement (CTHA), which led to a substantial reduction and harmonisation of chemical tariffs (Harmonised System Chapters 28-39) in the signatory countries. Participants in the Agreement agreed to harmonise tariffs at three levels: zero, 5.5%, and 6.5%. The tariff cuts by CTHA signatories were provided on an MFN basis, irrespective of whether the exporting country has participated or not. As a result, MFN tariff rates for chemicals have been reduced considerably. As of August 2004, the number of participants has expanded to 26 counting the EC (25 members) as 1, with the addition of new participants such as PRC and Taiwan.

On 4 July 2005, Canada, Japan, Norway, Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu, Singapore, Switzerland, and the United States submitted a proposal on tariff liberalisation in the chemical sector which follows up on the CTHA in the Uruguay Round (TN/MA/W/58). The proposal calls for wider participation while providing special and differential treatment to developing countries in the form of longer implementation periods, zero for “x”, and partial participation.

Source: OECD (2006), p. 119.

37. International commitments not only support the case for market opening regulatory reforms, but can also sustain domestic processes of economic reform. As international rulemaking tends to support good regulatory practice, participating in such processes and making international commitments can directly contribute to domestic processes of regulatory reform. The reference paper in the basic telecommunication negotiations at the WTO is a case in point, greatly contributing to the smooth transition from a regulatory framework based on a state owned monopoly to a regulatory framework based on interconnections. At the regional level, the case of Mexico’s avocado exports to the United States shows how regulatory co-operation facilitated by an international agreement can support domestic regulatory reforms allowing exporters to benefit from existing market opening reforms in a trading partner (see Box 10).

Box 10. Bilateral and regional regulatory co-operation: Mexico-US avocados

Bilateral and regional trading arrangements (RTAs) can sometimes provide an effective framework for addressing difficulties posed to developing economies when exporting to developed markets, such as meeting sanitary and phytosanitary (SPS) requirements.

Under NAFTA, Mexican growers have benefited from trade liberalisation on avocado exports to the United States market, but actually accessing these benefits has depended on the NAFTA institutional framework, which facilitated co-operation between SPS regulatory authorities in the two countries to meet SPS standards in the US. Beginning in 1990, bi-national meetings between the USDA Animal Plant Health Inspection Service (APHIS) and Mexico's Ministry of Agriculture and local phytosanitary control boards (JLSVs) resulted in APHIS inspectors overseeing programmes implemented by JLSVs to build the capacity of Mexican farmers to meet high SPS standards. Culminating in 1997 with APHIS certifying four Mexican municipalities as pest free, this programme of regulatory co-operation provided access for Mexican avocado exports into the US while addressing the risk of infestation over which California growers had raised concerns. NAFTA had foreseen a programme of bilateral meetings between national SPS regulatory authorities, providing a mechanism for resolution that would otherwise have been much more difficult to attain.

Source: OECD (2005), p. 117.

38. Policy makers often rely on international commitments as a means to secure market opening regulatory reforms. In doing so, they normally cite the benefits for domestic exporting sectors. It is also useful to consider however that locking in market opening reforms internationally can facilitate structural adjustment within the domestic economy.²² By reducing regulatory uncertainty and thus supporting investment and the reallocation of economic resources to more efficient sectors, the domestic economy benefits as a whole. The benefits for market opening reforms are strengthened when they are committed to internationally. The case for market opening regulatory reforms committed to at the international level is strengthened when benefits are realised by the domestic economy as a whole, in addition to exporting sectors.

39. In addition, relying on international agreements can lend credibility to gradual reform processes, which are normally more susceptible to lethargy over time. In instances where domestic constituencies would refuse to support rapid processes of reform and adjustment, they may be inclined to support gradual ones. Reform on a gradual basis can in itself be an important way to ease adjustment and facilitate efficiency enhancing shifts in the allocation of economic resources.²³ However, timelines should be transparently established to reduce regulatory uncertainty that tends to impede the adjustment process. Market opening reforms based on gradual timelines should be transparent and time bound. Conducting reforms in such a manner can help to ensure that the exit of inefficient producers, and the entry of more efficient ones, is not deterred by regulatory uncertainty. The case of the European shipbuilding industry demonstrates how international commitments can lock in policies to facilitate the exit of inefficient producers, while enhancing the competitiveness of the industry as a whole (see Box 11).

Box 11. Targeted policies: the European Union shipbuilding industry

Structural adjustment within the EU shipbuilding industry is marked by a long-term and steady decline in its world market share from over 60% in 1960 to less than 15% in 2000. The concentrated impact and non-market considerations influencing policy approaches towards the shipbuilding industry can only be partially appreciated based on the 70% decline in the work force (to 126 761 employees) between 1975 and 2003. Targeted policies formed two categories including Community-wide subsidy disciplines to reduce distortions in production and assistance to facilitate restructuring for competitiveness.

Policy response at the Community-wide level on shipbuilding emerged in 1970 and by the 1990s, three consistent approaches to disciplining subsidies for shipbuilding had emerged. First, the maximum allowable “contract-related production aid” was progressively reduced from 28% in 1987 to 9% in 1993. Second, “investment aid” to restructure shipyards was not allowed to result in the addition of overall capacity, and if it did so, capacity had to be equally reduced elsewhere. Finally, “closure aid” was allowed only to finance unemployment assistance for retrenched workers (not closure of the shipyards themselves) and capacity reductions had to be irreversible.

To enhance the competitiveness of the EU shipbuilding industry, selective “investment aid for innovation” was made available in addition to R&D aid that was generally available for the overall industry. “Aid for modernisation/upgrading” was also allowed in the form of regional investment aid on the condition that it was not used for financing the restructuring of shipyards.

Source: OECD (2005), p. 96.

40. Caution should be exercised however not to overuse international commitments as a lever of support for domestic reform processes. In the past, IMF and World Bank programmes have often been relied upon as means to signal credibility. Particularly where domestic constituencies have doubted the legitimacy of reforms supported in such a way, there have been instances of policy reversals as a result.²⁴

FDI facilitates structural adjustment and a good regulatory framework facilitates FDI

41. While FDI can greatly facilitate structural adjustment and support export prowess, this can best be achieved through a business friendly environment for all investors rather than promotion measures exclusively targeted at FDI. The domestic economy often remains the primary source of investment and where large incentives are provided to FDI, domestic investors can be disadvantaged thus potentially reducing support for continued reform from that constituency. Concentrating on providing a business friendly environment for all investors should be the main approach, as the quality of the overall business environment (e.g., political stability, macroeconomic stability and good infrastructure), remains the most important determinant of investment. A liberal overall domestic regulatory environment appears to be the primary factor explaining inward FDI in a number of developing economies countries (see Box 13).

Box 12. A business friendly and liberal regulatory environment can be the most potent draw for FDI

Reliable telecommunications services and FDI friendly policies have helped create new export industries in labour intensive and capital scarce countries with well trained graduates. The Indian IT services (ITS) and business process services (BPS) industry delivers services through information and communications technology (ICT) networks – which initially were special cable networks connecting major IT hubs – and currently employ more than one million workers (Nasscom, 2005). In the year ending March 2005, India exported USD 17.2 billion worth of ITS and BPS. The Philippines is another developing country which is quickly establishing itself as a global champion of voice-based BPS. In 2005, figures from the Philippine government indicated that the supply of ITS and BPS was worth USD 2 billion and the industry employed around 100 000 call centre workers. The country's early and complete liberalisation of the telecommunication sector translated into a competitive advantage in providing these services as investment in telecommunications equipment improved quality and competition drastically reduced prices.

Source: OECD (2006), p. 87.

Conclusions and the way forward

42. This paper has reviewed a number of OECD studies related to trade and structural adjustment and outlined insights relevant for policy makers faced with the need to advocate for and secure continued support for market opening reforms *vis-à-vis* domestic constituencies. Potentially the most compelling insight is the fact that the evolving global economy is likely to continue generating the need for structural adjustment independently of whether domestic economies undertake new market opening reforms. This supports the case for engaging market opening regulatory reforms that will facilitate structural adjustment and enhance national economic competitiveness.

43. The extent to which economies were successful in implementing OECD best practices in regulatory quality generally, and regulatory reform for market openness specifically, provides an important basis and body of experience for efforts to obtain backing from domestic constituencies for new market opening reforms, and for consolidating support to sustain them. Case studies on successful structural adjustment have provided some insights into how to make a credible case for market opening regulatory reforms and how to bundle reforms in a manner attractive to domestic constituencies. Taken as a whole, the case studies on structural adjustment represent a compendium of approaches to designing, implementing and managing opening reforms, and the structural adjustments they may entail. These case studies show how reforms to meet the challenges of structural adjustment have yielded economic benefits in practice. *Vis-à-vis* the domestic economy, the most convincing case that can be made by policy makers for new market opening regulatory reforms and bringing domestic constituencies aboard to sustain and consolidate them once initiated, is a solid track record of success with previous and current reform process.

44. This study also points in the direction of areas where further research would serve to better crystallise understanding on how to make the case for market opening regulatory reforms, and how to increase the appeal of sustained reform in the eyes of domestic constituencies. Further original research on concrete and effective ways for policy makers to prepare for and to advance reform in light of political economy related constraints, would represent a constructive way forward.

45. Topics worthy of further original research may include:

- How often and effectively consultation, Regulatory Impact Assessment or or surrogate institutional processes have been employed to identify the spectrum of domestic constituencies that are likely to be negatively or positively impacted by planned market opening regulatory reforms.
- How to manage expectations of the various domestic constituencies throughout the reform process including: during the pre-reform period; at the onset of the market opening reforms; at the time when negatively impacted constituencies engage in lobbying for standstill (or reversal) of the reforms; and at the time when new reforms are again being considered.
- Deepening understanding of the implications of developing best practices, including effective mechanisms for compensating negatively impacted constituencies.
- How to motivate and support beneficiary constituencies (*e.g.*, by preparing relevant data, information and policy postures) to better advocate reforms in public debates throughout the various stages of reform.
- How to prepare and support political leaders to publicly advocate reforms throughout the various stages of reform, including when under pressure from constituencies that are likely to be adversely impacted.

Notes

1. OECD (2007), p. 7.
2. OECD (2005), p. 73.
3. OECD (2005), p. 79.
4. OECD (2005), p. 93.
5. OECD (2006), p. 94.
6. *Ibid*, pp. 93-4.
7. OECD (2005), p. 93.
8. OECD (2006), Para 35.
9. *Ibid*, Para 34.
10. *Ibid*, p. 18.
11. OECD (2007), p. 18.
12. OECD (2007), p. 18.
13. OECD (2007), p. 44.
14. OECD (2006), pp. 115-143.
15. *Ibid*. (2006), Para 120.
16. *Ibid*, Para 259.
17. OECD (2007), p. 18.
18. OECD (2006), Para 153.
19. OECD (2005), p. 75.
20. OECD (2007), p. 26.
21. *Ibid*. p. 18.
22. OECD (2006), p. 6.
23. *Ibid*.
24. OECD (2006), Para 42.

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