G20 Workshop Paris

Seminar on Assessing the Impact of Structural Reforms

The Short-term impact of structural reforms and the role of macroeconomic situation: A discussion

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The views expressed here are those of the author and do not necessarily reflect the views of the BIS.
General framework: The secular stagnation debate

- Summers (2014)
  - “US economic growth has averaged only 2% over the last 5 years despite having started from highly depressed state.”
  - “Credit spreads in Europe have come way down and fears of the dissolution of the Eurozone have been sidelined, yet growth has been glacial over the past several years and is not expected to rapidly accelerate.”

- What is currently holding back growth?
  - Regulation

- What is the policy response?
  - Structural reforms
What is the issue with structural reforms?

- Structural reforms embed two types of trade-off:
  - Cross-sectional (losers vs. winners)
  - Inter-temporal (short-run losses vs. long-run gains)

- These two trade-offs may interact with each other
  - The time profile of net gains to reforms depends on idiosyncratic characteristics.

- The economic environment affects these trade-offs:
  - Business cycle and macroeconomic policy
  - Access to finance and Financial disruptions
Structural reforms and the business cycle

- Structural reforms may cement adverse dynamics:
  - Key example: relaxing firing regulations during downturns, in times of high or rapidly growing unemployment.

- Structural reforms lift aggregate supply but can have detrimental effect on aggregate demand:
  - In the short-run, output is demand determined.

- Macroeconomic policy can help undo/reduce such negative side-effects but faces two types of issues:
  - Room for maneuver
  - Effectiveness
The OECD paper

- Congratulations to the authors:
  - Comprehensive and well documented paper with clear policy conclusions

- Paper first deals with the time pattern of the dividend to structural reforms under “normal” times.
  - Rather optimistic view: (NPV) gains exceed losses even in the short-run, particularly for UB and ALMP reforms.

- Second, the paper looks at the specific case of introducing structural reforms under weak demand conditions.
The OECD paper

- Structural reforms under weak demand conditions:

- Example: reforms affecting unemployment benefits
  - Striking point: simulations to UB reforms seem to generate a self-perpetuating slump.

- Fiscal and monetary policy can provide useful relief.
  - Mitigate adverse effects on AD (tax rebates, public investment).
  - Questions: Room for maneuver (ZLB, public debt, incentives), effectiveness
The EC paper

- Quantification exercise: How big is the effect of structural reforms?
  - Two step procedure: (i) translating structural reform measures into quantified changes in variables, e.g. mark-ups, (ii) estimating the effect of such change in a DSGE model.

- Exercise carried out for Italy, Spain, Denmark, Czech Rep.
  - Based on National Reform Programs (2013, 2014).

- Main results
  - Closing half the gap to best performers: +3½ % on GDP. NRP can bring up to 0.2 pp to potential growth over 5 years.
  - Yet, significant cross-country heterogeneity
Structural slumps and the SR cost of structural reforms

- Contrasting balanced and unbalanced downturns
  - Not all output gaps are born equal.
  - Nature of the downturn depends on the nature of the preceding boom.

- Balanced downturns, generalized recession across the economy, unbalanced ones driven by specific parts/sectors.
  - Unbalanced downturns deeper, longer, more likely associated with financial disruptions, **larger need for reallocations** (BIS AR 2012).

- Implication
  - Barriers to reallocations are more costly when the economy faces an unbalanced downturn.
Financially driven slumps and policy effectiveness

- Macro policy effectiveness depends on a set of factors
  - Monetary policy: well functioning credit channel.
  - Fiscal policy: credit availability for the private sector.

- In a financially driven slumps, neither condition is satisfied.
  - Macroeconomic policy may be less effective in combating strongly negative output gaps in times of financial distress (BIS AR 2014).

- Implication
  - In this environment, macro policy best at curing the cause – through financial repair- than dealing with the symptoms.
Thank you for your attention