PARIS, 1 JUNE 2015

SEMINAR ON ASSESSING THE IMPACT OF STRUCTURAL REFORMS

SESSION 5:
INTERNATIONAL SPILLOVERS OF STRUCTURAL REFORMS

- DISCUSSION -

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Outline

• General remarks on SR and their effects.

• What the presentations have to say about them…

• Conclusions
Open issues with SR

- **Short-run** / **long run** effects of SR  (*wide literature*)

- **“normal times”** / **“crisis times”**  effects of SR  
  (*Eggertsson et al. 2014*)

- **Sequencing / mixing** of SR  (*Blanchard-Giavazzi, 2013*)

- **Spillovers across countries** (*less investigated*)

- **Winners / losers** of SR  (*affected by spillovers?*)
Not all SR are alike…

- The **long run effects** of SR are unambiguously positive…
  - but great **uncertainty** remains regarding the speed with which such **gains accrue in the short-run** (2 yrs)

- **Key Parameter**: **IES** (*intertemporal elasticity of substitution*)
Not all SR are alike…

- **Bureaucracy and regulation**: (red tape reduction, faster and clearer regulation for insolvency and bankruptcy) shouldn’t have *deflationary effects* BUT … long term gains are more uncertain (smaller???)

- **Tax reform, unemployment benefit reforms**: (moving from direct to indirect taxation, from employers social contributions to VAT, introducing more generous but conditional benefits) ➞ positive short run effects even in “bad times”? 
Short vs long run & normal vs crisis times

- Eggertsson, Ferrero and Raffo, 2014, “Can Structural Reforms Help Europe?” argue that, in the euro area, SR do more harm than good, as potential short-run losses might be sizeable and quickly erode political support for them.

- Key distinction: “normal times” (monetary policy accommodation) and “crisis times” (ZLB) affects results via real interest rates
Short vs long run & normal vs crisis times

- *Gerali, Notarpietro and Pisani, 2015*, (DSGE model) show that, when competition-friendly reforms are introduced in a single EA country the increase in real interest rate (ZLB channel) is enough to induce a short-run negative response of GDP but…

- *when SR* are undertaken simultaneously the *spillover effects* create enough external and internal demand to increase overall inflation and rise EA GDP from their inception, even under very negative macroeconomic conditions
IMF - G20MOD Analysis

- **G20MOD** is semi-structural model, single good with reduced-form trade, but sufficient structure to address key tradeoffs:
  - **Consumption**: OLG framework with relevant non-Ricardian properties
  - **Investment**: Tobin’s Q (depreciation, corporate tax, marginal product of capital, marginal cost of adding a new unit of capital): $Q > \text{market price of capital} \Rightarrow I \text{ rises}$
  - **Supply**: Cobb-Douglas with TFP depends on the level of the public capital stock + productivity spillovers from innovation in trading partner economies
  - **World real interest rate** is endogenous and equilibrates D and S of global savings
IMF - G20MOD Analysis

- **Key transmission channels are:**
  - Productivity
  - Labour supply
  - Infrastructure investments

- **RESULTS *(5 years horizon):***
  - Roughly 25% of SR impact on G-20 GDP comes from spillovers
  - Productivity channel account for 1/3 of spillovers
Bruno’s Analysis

- **Productivity shocks** generated by SRs (“Reduced-form” view of structural reforms; NiGEM model)

- Focus on the **medium term** (5 years) impact of SRs
  - 1% *P-shock* in one country
  - 1% *P-shock* in all G20 countries
  - *P-shock* with size depending of the distance to frontier in G20 countries
Bruno’s Analysis

**RESULTS**
- heterogeneous responses to SR (countries flexibility)
- *Spillovers* are globally *significant* and *positive*
- Possible *short run pain* (exp. labour mkt)

Response normalized by size of domestic shock
Conclusions -1/3

**POSITIVE RESULTS**

- VERY RICH AND WIDE RANGING ANALYSIS
- SPILOVERS MATTERS IN BOTH MODELS (robustness check)
- SPILOVER ARE POSITIVE FOR ALL COUNTRIES
- ... BUT COUNTRY CHARACTERISTICS MATTER FOR THEIR SIZE.

**OPEN ISSUES**

- PROBLEM OF POTENTIAL SHORT RUN LOSSES NOT FULLY TACKLED
- PRODUCTIVITY SHOCK: WHERE DOES ITS KEY ROLE STEM FROM? OTHER PARAMETRIZATIONS WOULD GIVE IT THE SAME RELEVANCE?
- SR MIX MATTERS? WHAT IF BOTH SURPLUS AND DEFICIT COUNTRIES IMPLEMENT PRO-COMPETITION POLICY... WOULD IT NOT IMPOSE MORE «REAL DEFLATION» TO DEFICIT COUNTRIES TO REACH EQUILIBRIUM?
- WINNERS & LOSERS INSIDE EACH COUNTRY?
Conclusions – 2/3

The short-term impact of most SR depends on the response of AD to expectations of higher permanent income (wealth effect).

But…

1) policy rates are at the ZLB and fiscal policy constrained by long-run consolidation efforts in many areas

2) we cannot exclude that expectations of some agents are adaptive or driven by learning-type processes

→ weak cyclical conditions could then lead households and businesses to downgrade their assessment about the long-run benefits of SR.
Conclusions – 3/3

Even credible and well-designed supply-side policies might fail to deliver results in the short run …

⇒ if all countries pursue structural change simultaneously, the strength of the wealth effect can be much larger but spillover may not suffice

⇒ Sequencing / cross country mix of SR is important: (say: public investment in Germany, labor market reform in Spain, competition reforms in Italy and France, might activate enough demand, boost confidence and favour “rebalancing”).

⇒ a reasonable view in the current environment is that the ability of SR to generate growth and public support still depends on “companion” policies creating enough demand in the short-run.