

Structural reforms: what is necessary and what is sufficient for growth?

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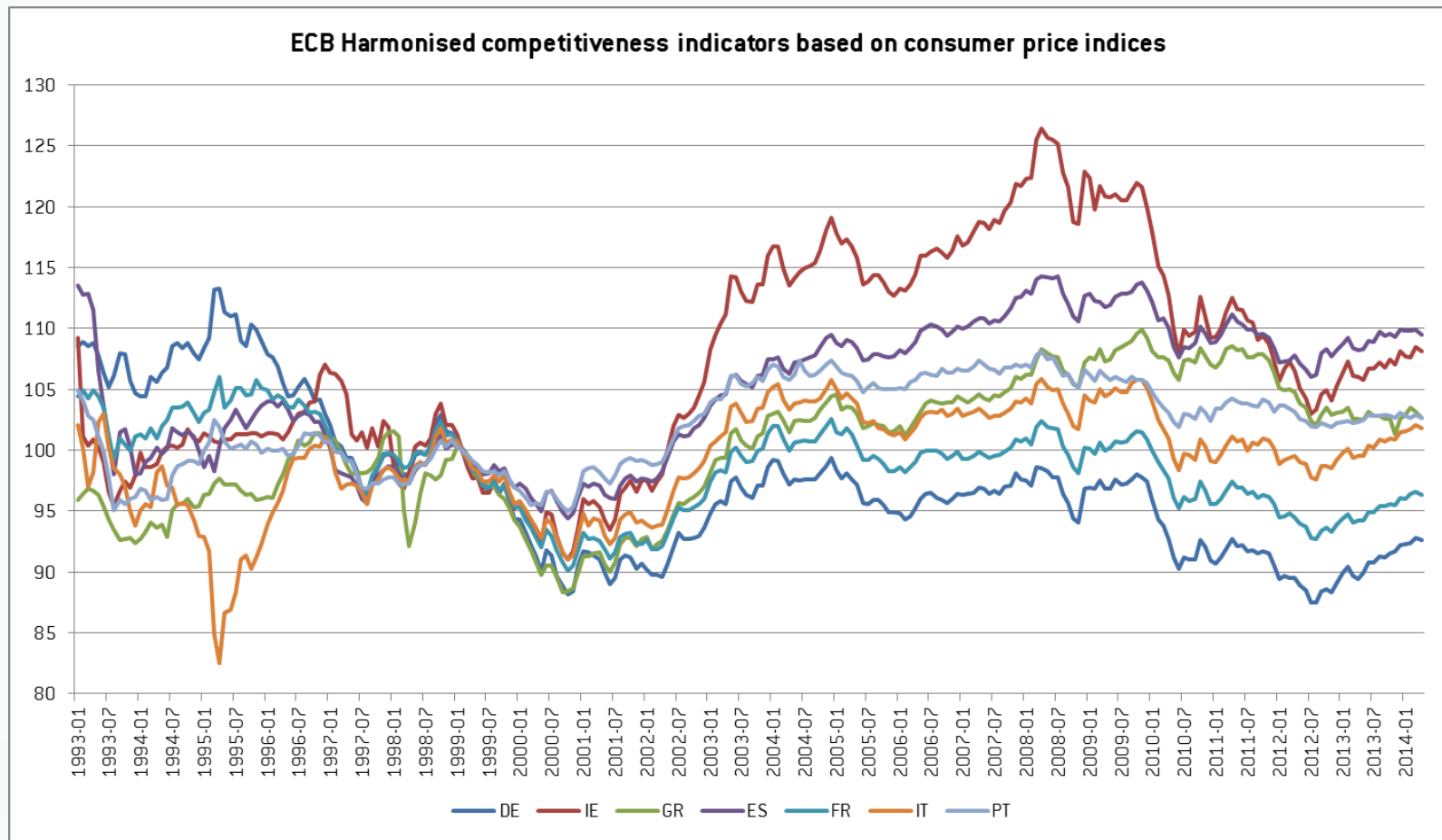
What are structural reforms?

- **Catch-all phrase that has been used for many different things**
- **Broadly defined, it can have two main purposes:**
 - **reduce burden on existing activities and increase incentives for investment and hiring**
 - **allow for an easier re-allocation of labour between jobs, particularly relevant in the context of adjustment that the euro area is undergoing**

Outline

- **adjustment challenge**
- **Look at some reform measures**
- **Ask questions**

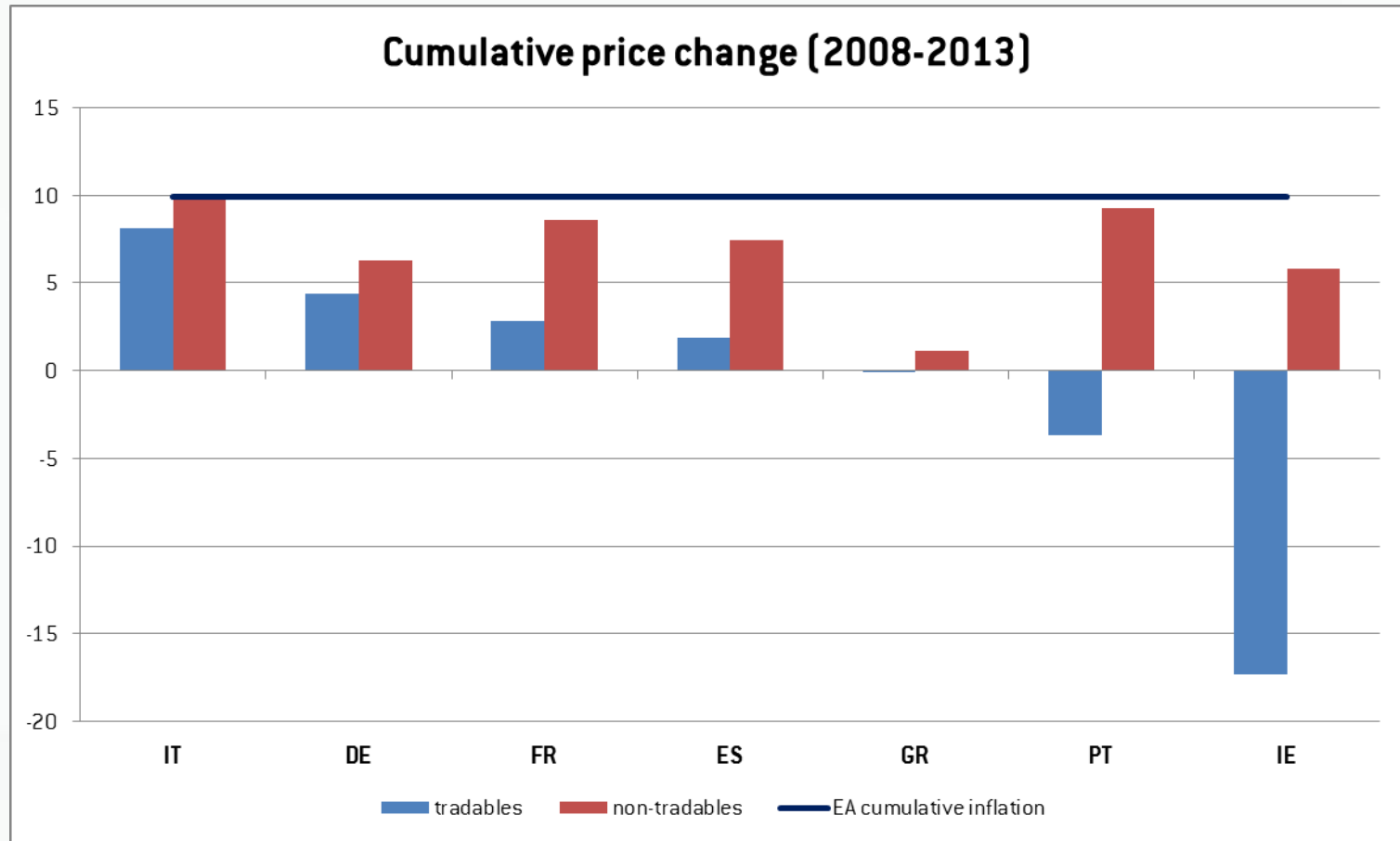
Price competitiveness



Definition: ECB Real effective exch. rate CPI deflated, Euro area-18 countries vis-a-vis the EER-39 group of trading partners (AU, CA, DK, HK, JP, NO, SG, KR, SE, CH, GB, US, BG, CZ, LT, HU, PL, RO, CN, DZ, AR, BR, CL, HR, IS, IN, ID, IL, MY, MX, MA, NZ, PH, RU, ZA, TW, TH, TR and VE) against Euro

Note: period averages; index 1999 Q1=100

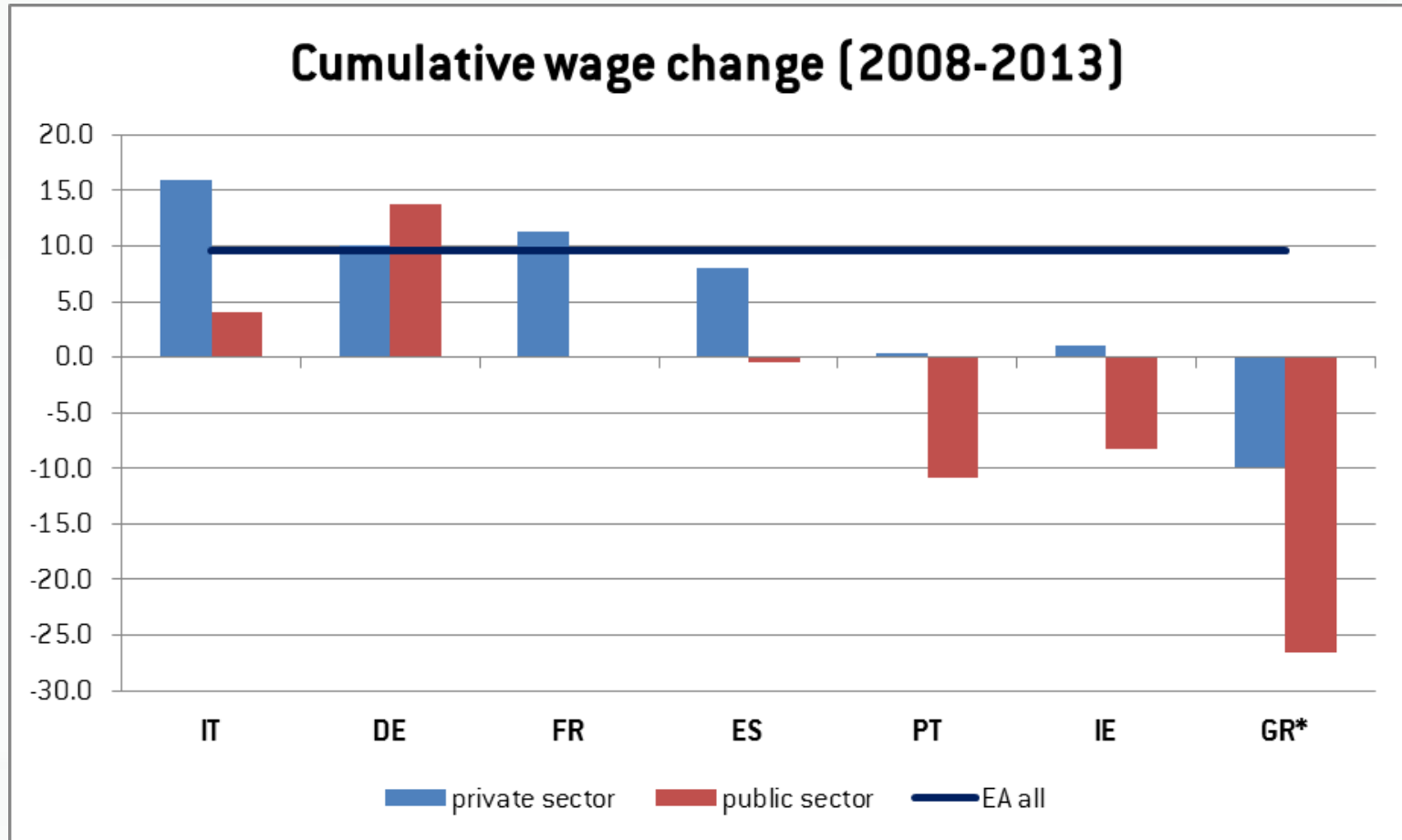
Price change in tradable vs. non-tradables



Note: tradables: HICP - Industrial goods excluding energy; non-tradables: HICP services

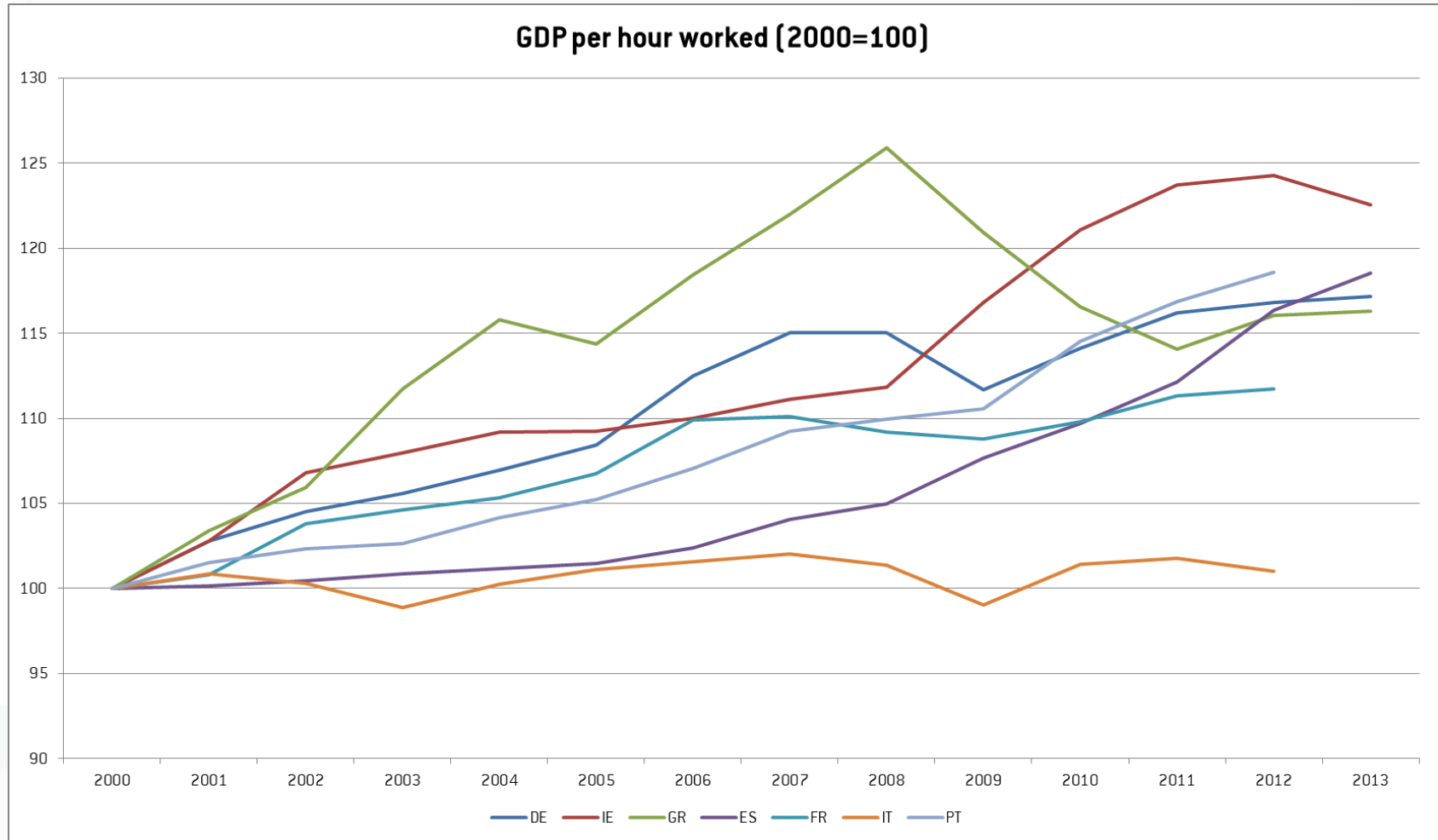
Source: ECB, Bruegel calculations,

Adjustment in factor prices - wages



**2008Q2 and 2013Q2 was used due to data availability
Source: Eurostat, Bruegel calculations*

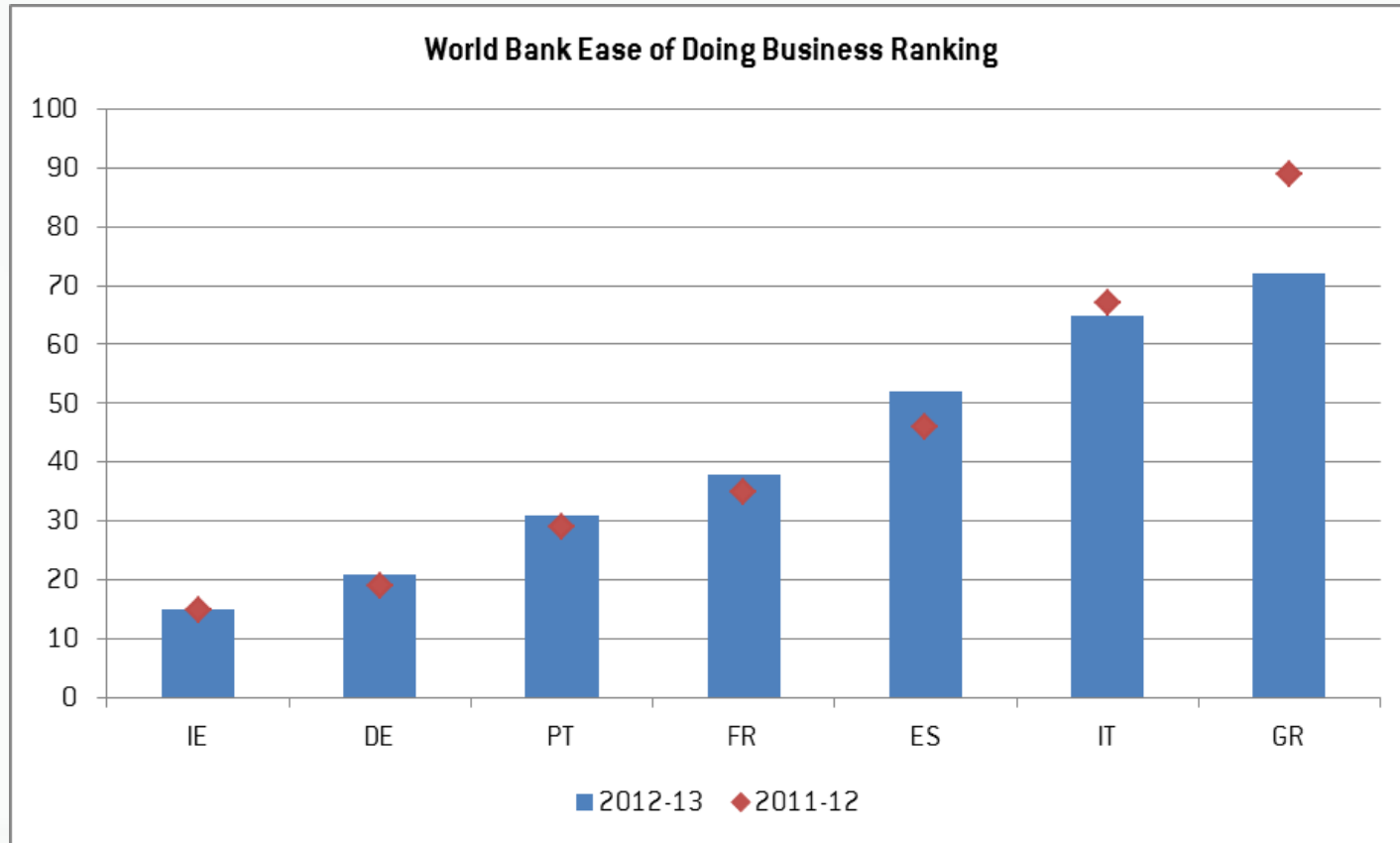
Labour productivity – the big problem, can structural reforms help?



Definition: Euro, chain-linked volumes, reference year 2005 (at 2005 exchange rates)/hours worked

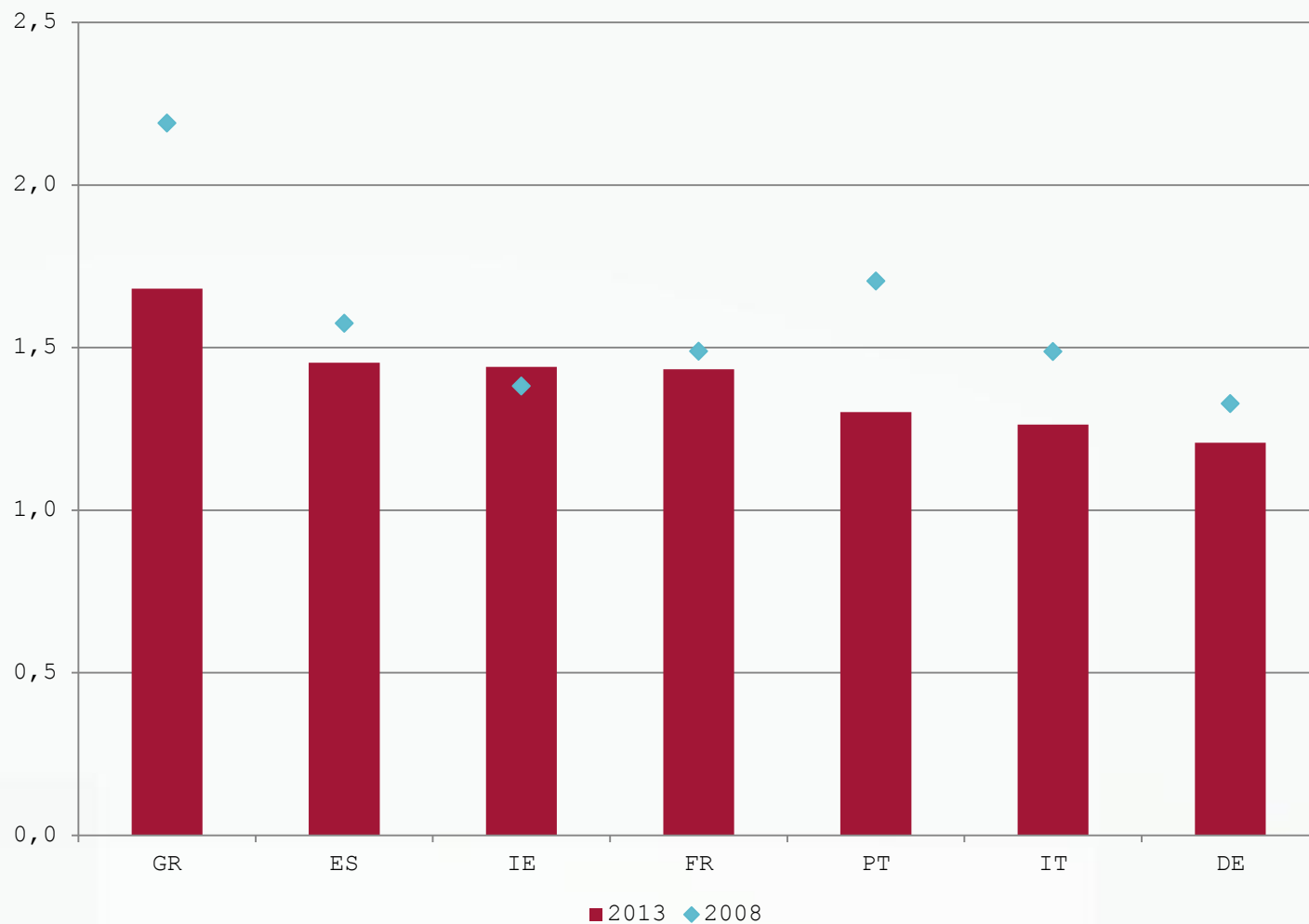
Source: Eurostat, Bruegel calculations

World Bank Doing Business ranking

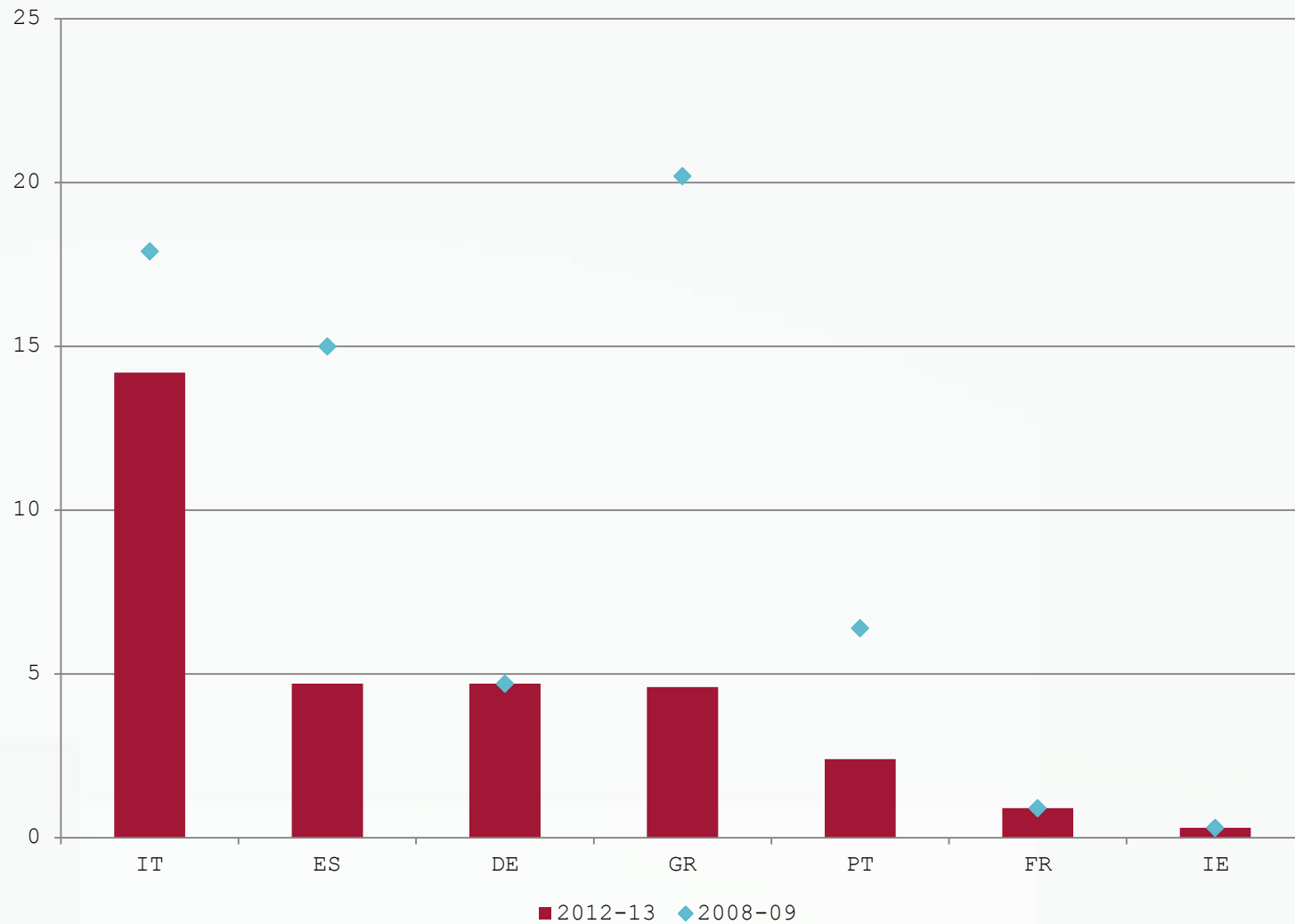


Note: an increase indicates a worsening in the ranking; periods indicated are those when the survey was actually run and correspond to DB2014 and DB2013, respectively.

Product market regulation (OECD)

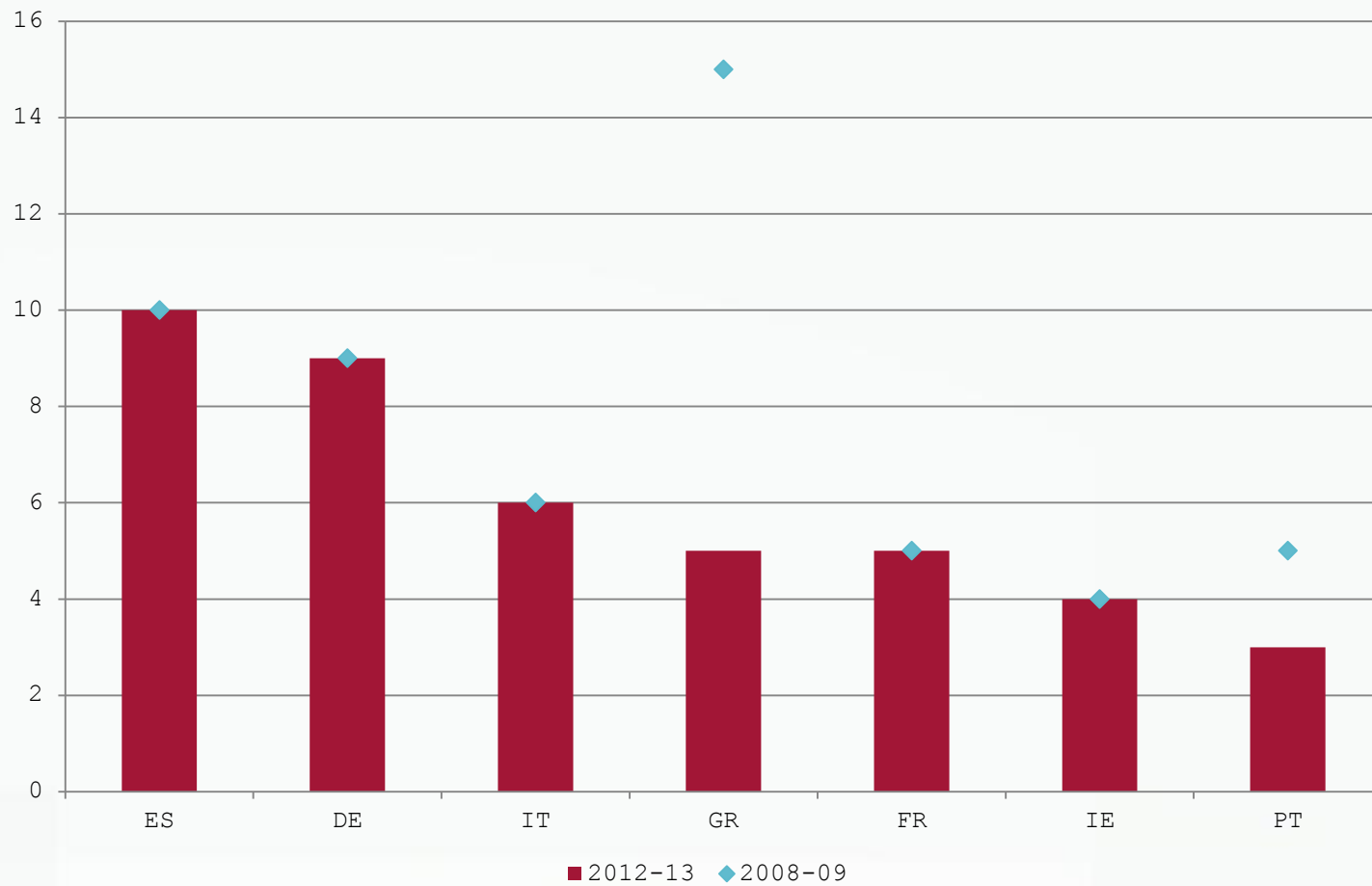


Cost of starting business



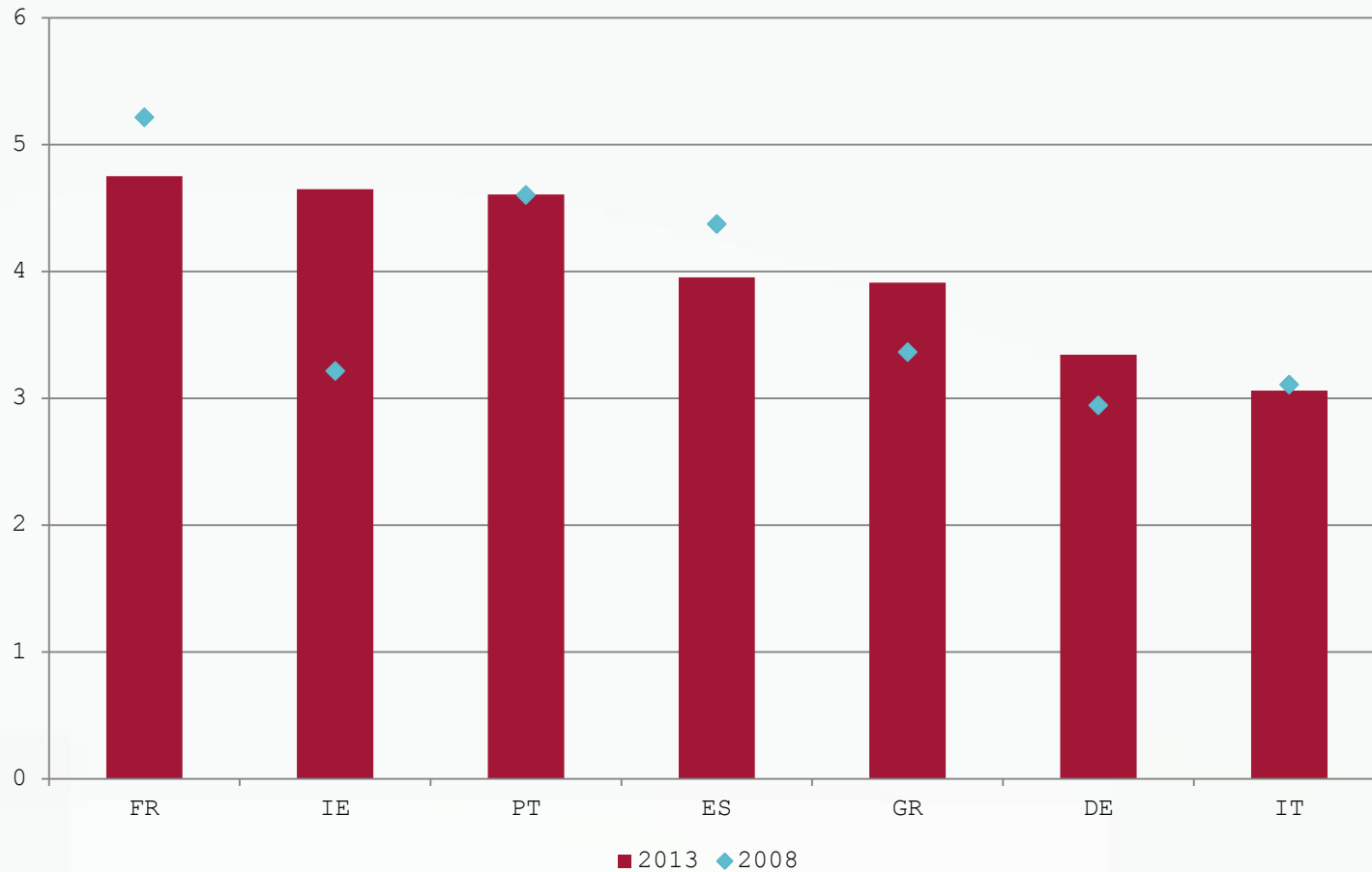
Source: World Bank

No of procedures to start a business



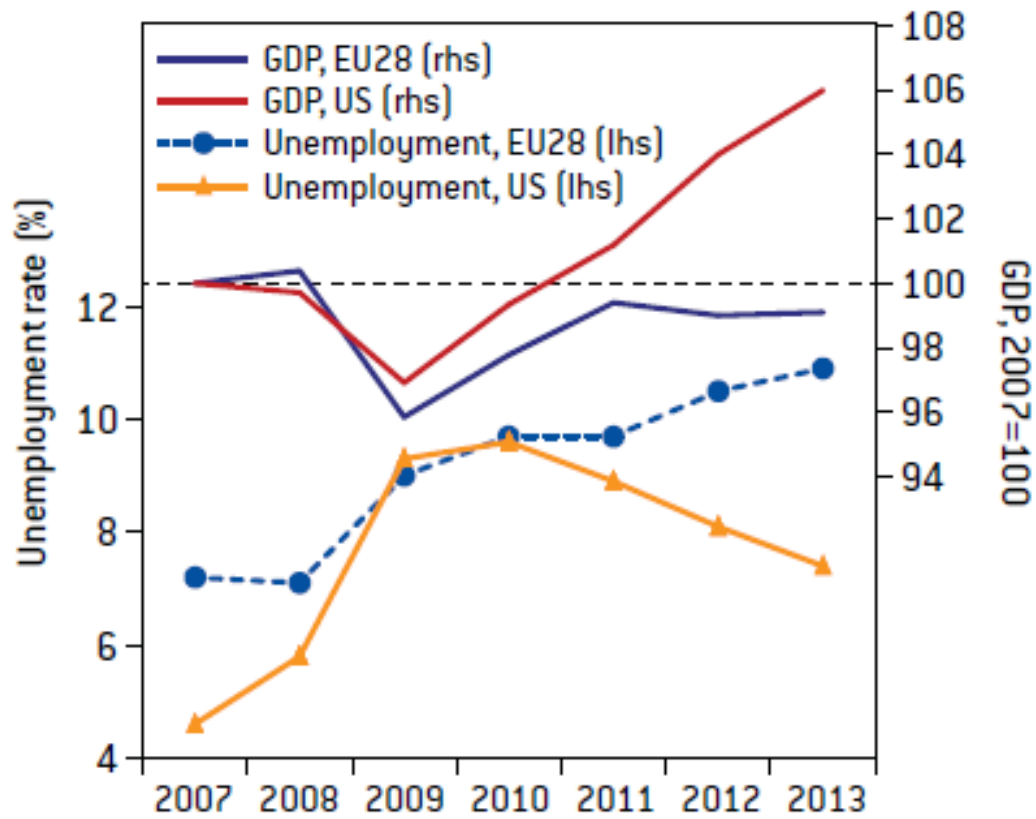
Flexibility of wage determination

Flexibility of wage determination, 1-7 (higher)



Don't forget the macro story

GDP and unemployment in Europe and the USA



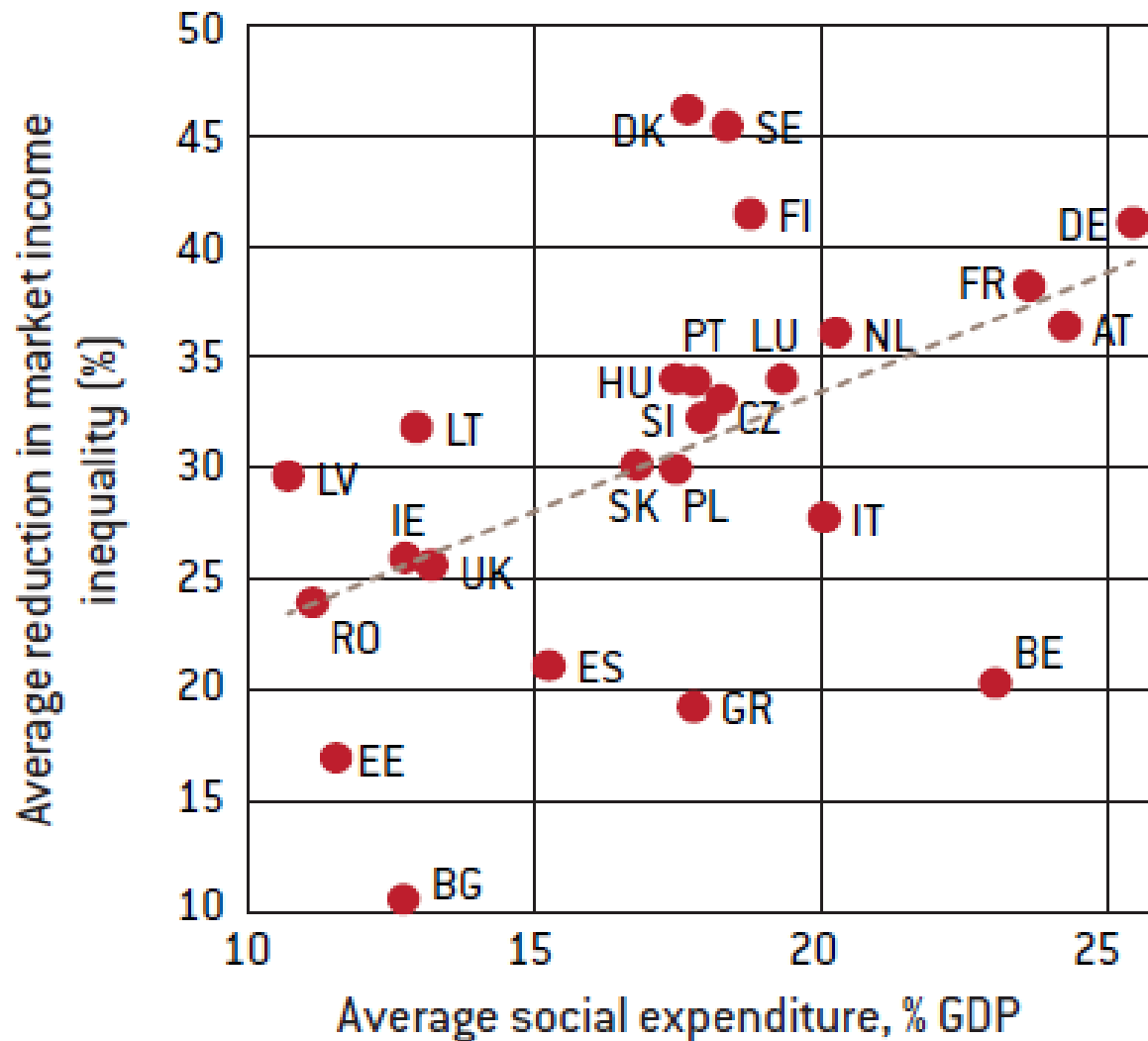
Source: Bruegel. Note: rhs = right-hand scale; lhs = left-hand scale.

Growth performance worse in Europe due to delayed bank clean-up and wrong macroeconomic policy decisions in 2011.

Questions – a rich research agenda ahead

- **How important is de-regulation, i.e. increasing the ease of doing business and increasing competition, for factor re-allocation when demand is compressed?**
- **What does increasing wage flexibility mean in a context of close to zero inflation? Does it remove downward nominal rigidities? Is the issue wage flexibility for existing contracts or for new entrants?**
- **Is the central problem of sectoral re-allocation of workers the regulation of the sector? What role for the education system (construction workers becoming engineers? or receptionists?)**
- **Also largely unexplored: the role of the state:**

Revisiting the role of the state: efficiency and size



Composition of fiscal adjustment

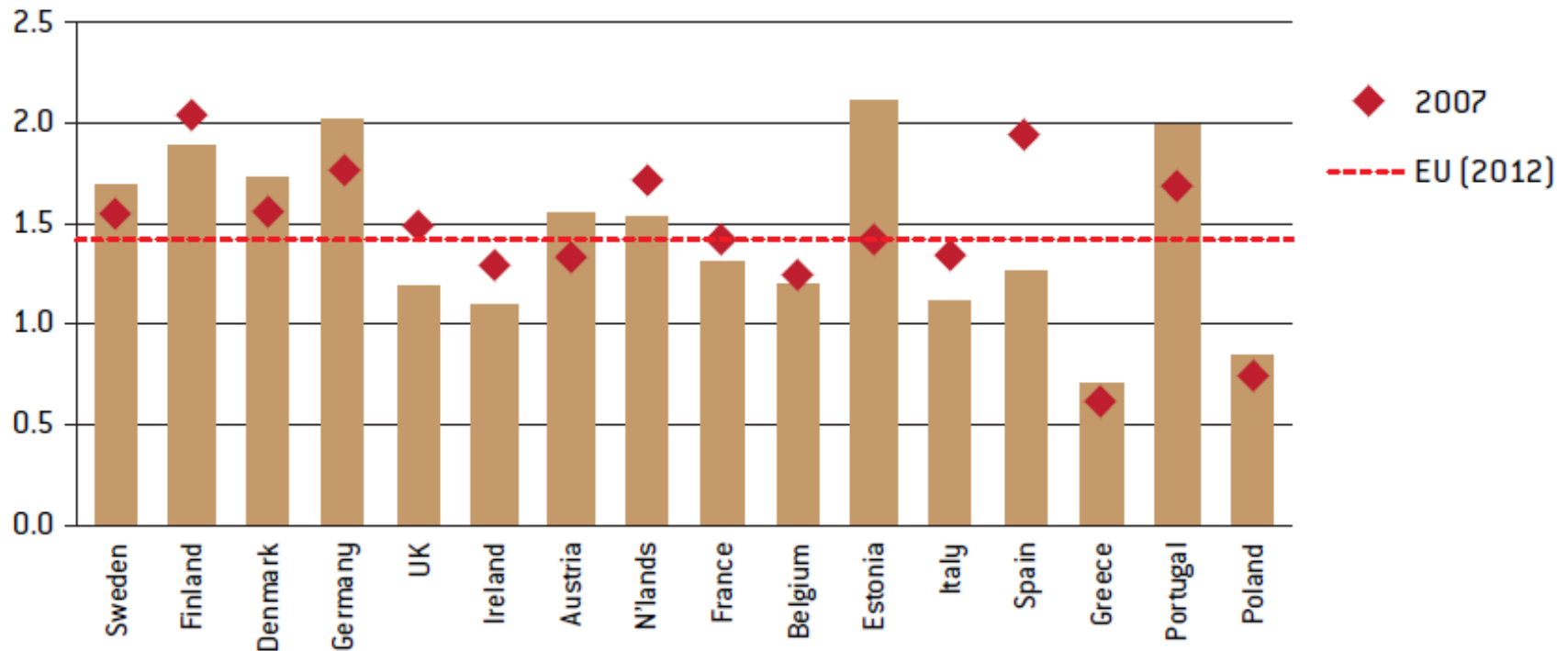
Table 1: General government expenditure by function, % change 2009-12 (in current prices and constant exchange rates)

	EU24 (share)	EU24	Greece, Ireland, Portugal	Italy, Spain	9 other EU15	Baltics	7 other CEE
Total general govt. expenditure	100	4	-12	1	6	-3	7
Interest payments	5	23	14	32	19	164	22
Broad services	17	-2	-12	-11	2	-15	-1
Economic affairs	9	-5	-45	5	-6	-20	-4
Environment protection	2	-5	-26	-8	-4	-6	21
Health, recreation	17	4	-20	-7	8	-6	12
Education	11	2	-14	-10	5	-7	8
Old age	20	10	0	8	10	15	13
Family and children	4	0	-19	-10	3	-14	1
Housing	1	12	-30	6	13	23	20
Unemployment	4	0	11	14	-5	13	-11
Sickness and disability	6	7	-7	-1	9	-5	12
Other social protection	5	7	-11	5	9	26	8
Memorandum: inflation		8	6	8	7	12	10

Source: Bruegel using Eurostat's 'General government expenditure by function' (COFOG) database. Note: Belgium, Croatia, Slovakia and Romania are not included because of lack of data.

R&D government spending

Figure 3: Trends in government expenditure on R&I (GBORD as % of govt. expenditure), 2012 relative to 2007



Source: Bruegel calculations on the basis of Eurostat. Note: Countries are reported in decreasing order of Innovation Union Score; Innovation Union Scoreboard 2007.

- **If fully implemented, could increase EU GDP by ~2% (CESifo estimate).**
- **But implementation still difficult, numerous obstacles on harmonization of regulation, doubts about what it means for citizens**
- **maybe no deal before 2016**
- **What are the trade and political implications for China?**

Conclusions

- **Structural factors are undoubtedly key for the performance of our economies: education, research, competition, flexibility**
- **Empirical evidence is quite unspecific on which reforms matter most under what circumstances – big and difficult research agenda**
- **Regulations are no accident – they are the result of difficult political, social and more broadly democratic deliberations – difficult to change and may not necessarily be Pareto improving**
- **When reforming, one has to think about losers and winners**
- **Large and inefficient states are a serious problem: do not only suppress private sector but also perform badly → further burdening private activity**
- **Important role of state in ensuring competition**
- **Composition of fiscal adjustment is central for growth and social acceptability, bad choices have been made**
- **Right demand policies (monetary and fiscal) are indispensable.**

Thank you!