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# The Economic Impact of Structural Reform Measures in ES, FR, IT and PT

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*The analyses, opinions and findings of this document represent the views of the author, they are not necessarily those of the Banco de Portugal or the Eurosystem.*

# Outline

1. One model for all?
2. Some missing pieces
3. Short-run costs
4. Conclusions and possible ways forward

# 1. Working environment

Roeger et al. (2008), Varga et al (2014)

One model for all? YES, YES, YES!

- ▶ Easily fits different economies (rich environment)
- ▶ Mapping of structural reforms/model - economies of scale
- ▶ Avoids several issues: overlapping *vs.* infinitely lived; alternative impatience degrees; homogenous/heterogenous labour force

QUEST model: semi-endogenous growth version

- ▶ Households: liquidity and non-liquidity constrained
- ▶ ... low-, medium-, and high-skilled labour; unemployment
- ▶ Intermediate and final goods producers ... monopolistic competition
- ▶ R&D industry; Monetary authority; Fiscal authority
- ▶ Fixed costs/Costs of entry
- ▶ Unemployment benefits

## 2. Some missing pieces

On the real convergence/divergence topic, again!

- ▶ Growth rates convergence in the LR: do structural reforms *permanently* increase the rate of growth of the economy? If NO, please be clear about that!
- ▶ International linkages and real divergence: what if Country *A* reforms and Country *B* doesn't? No cost for country *B*?
- ▶ ...structural reforms as a “state-of-mind”!

Three additional topics:

- ▶ Financial frictions: external finance premium
- ▶ ZLB *vs.*  $\Delta i_t \equiv 0$  in small economies ... and  $r_t = i_t - \pi_{t+1}$
- ▶ State-dependent impacts? *e.g.* High HH and firms' debt levels?

### 3. Short-run costs

#### The current paper

- ▶ “When monetary policy is operating at the ZLB, ... the effects may be smaller in the short run”
- ▶ At the current juncture, with high indebtedness of households and firms, ... may also imply smaller benefits in the short run.

#### European Commission (2014): Structural reforms at the ZLB

Table II.1.2: **Impact of reforms with binding ZLB, euro-area periphery (1)**

Year	1	2	3	4	5	10
Real GDP	-0.01	0.13	0.29	0.38	0.43	0.57
Employment	0.01	0.06	0.13	0.16	0.18	0.26
Nominal interest rate	0.00	0.00	-0.01	-0.02	-0.02	-0.01

# Short-run costs

## Two references

- ▶ **Eggertsson, Ferrero and Raffo (2013)**: ... We show that, in a crisis that pushes the nominal interest rate to its lower bound, these reforms do not support economic activity in the short run, and may well be contractionary.
- ▶ **IMF (2016)**, Staff note for the G20: ... While some types of reforms tend to support short-term growth, others do not, possibly adding to a shortfall in domestic demand. This could further weaken potential output due to hysteresis effects, which, in turn, can depress expected future income and firms' profitability, thereby reducing consumption and investment today.

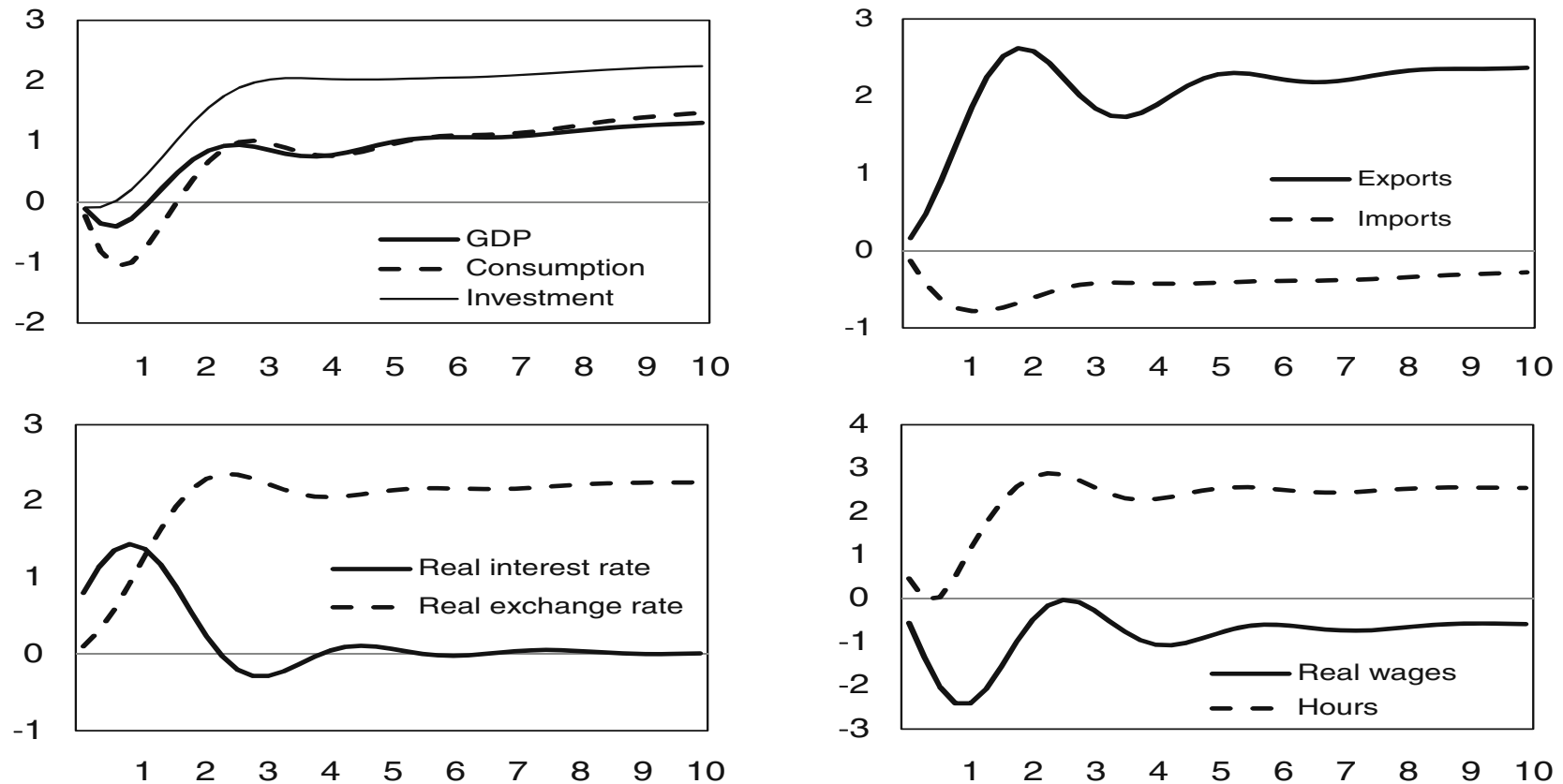


Figure 1: A product and labour market reform in *PESSOA*

**Product market reform:** permanent decline of 10% in the markup over marginal cost in the *Non-tradable* sector (decline of the markup from 20 to 18%).

**Labour market reform:** permanent decline of 10% in the steady-state wage markup (from 25 to 22.5%). In both cases, the impact builds up gradually, influenced by the persistence parameter, in which roughly 80% of the decline is achieved in two years.

## 4. Conclusions and possible ways forward

- ▶ It is indisputable that structural reforms have important micro and macro effects
- ▶ Great method: one model for all countries
- ▶ Effects are highly complex and challenging, both empirically and theoretically

### Ways forward and worries

- ▶ Why not a large multi-country model with international linkages?
- ▶ State-contingent reforms: ZLB, indebtedness levels?
- ▶ No short-run costs? No cost from *not* reforming?
- ▶ If no cost, why no proliferation of reforms? Where's the problem? Political? The people? Why don't we multiply the reforms by a factor of two, three, five...?