

# Structural Reforms myth and reality

Daniel Gros (CEPS)

**ECB Conference on Structural Reforms in the Euro Area**

**Frankfurt, 18 October 2017**

## Three issues

1. Spill-over effects of SRs.
2. Can one measure SRs?
3. Decades of Structural Reforms: where is the meat?

One observation:

Improvement biggest in area with least reforms.

## An aside: Define 'Structural Reform'

- Anything a government does (= National Reform Plans)?
- Or only elimination of rigidities in goods and labour markets?

# Rationale for structural reforms

Structural reforms should enhance flexibility and productivity, both always welcome. But in concrete cases the weight on these two aspects varies:

- Boom – Bust (real estate) => ‘flexibility’ key = need to facilitate movement of factors of production (both L and K) to traded sectors. Spain, Ireland, Sweden 1990s.
- Declining trend growth rates: productivity key (very country specific).
- Most modelling implies that SRs only increase the level of GDP, with a temporary impact on growth.

1) Why do we (EU level) care?

Spill-over effects of structural reforms

Reforms and EA governance: why do we care?

**Spill-over effects** But they are difficult to determine, both sign and magnitude.

- Positive or negative?
- Example: Germany 'Hartz' reforms: wages down, means Germany becomes more competitive.

⇒ other (EA) countries worse off?

Same for services sector reform: productivity up without wages up? Again gain in competitiveness.

Why do we (EU level) care?

Spill-over effects of structural reforms

Rationale of spill-over effects in general nominal rigidities.

⇒ In long run no spill-over, or only pecuniary ones.

Confirmed by ECB 2015: in the long run the impact of unilateral and coordinated reforms the same.

## 2. Structural reforms: Where is the meat?

Magic formula is 'Structural reforms plus investment in human capital'.

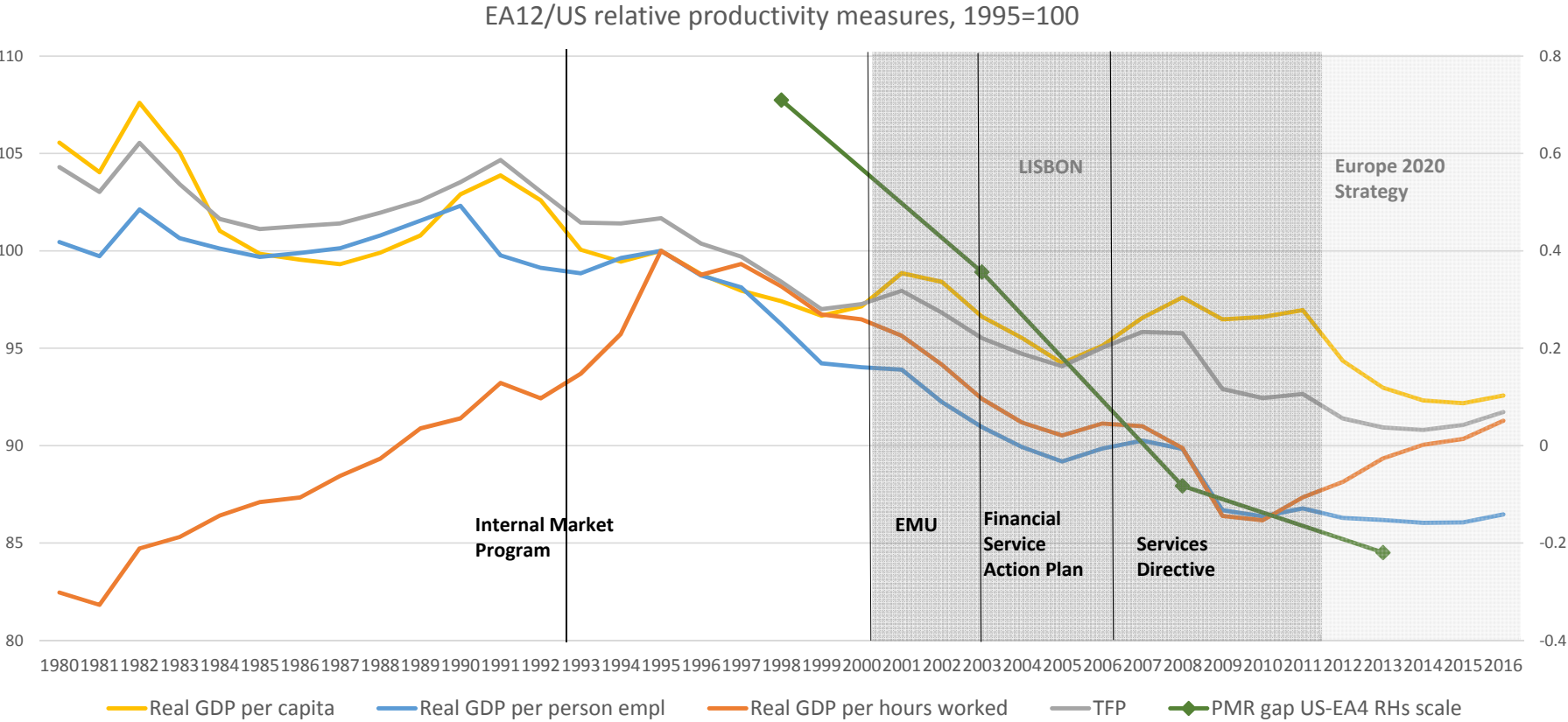
Europe active on both fronts:

- 1) Since early 1990s many big EU integration initiatives with supposedly large benefits.
- 2) Continuous 'structural reform' mantra.

What has been the result?

Disappointing!

# Deterioration of EA performance since 1995

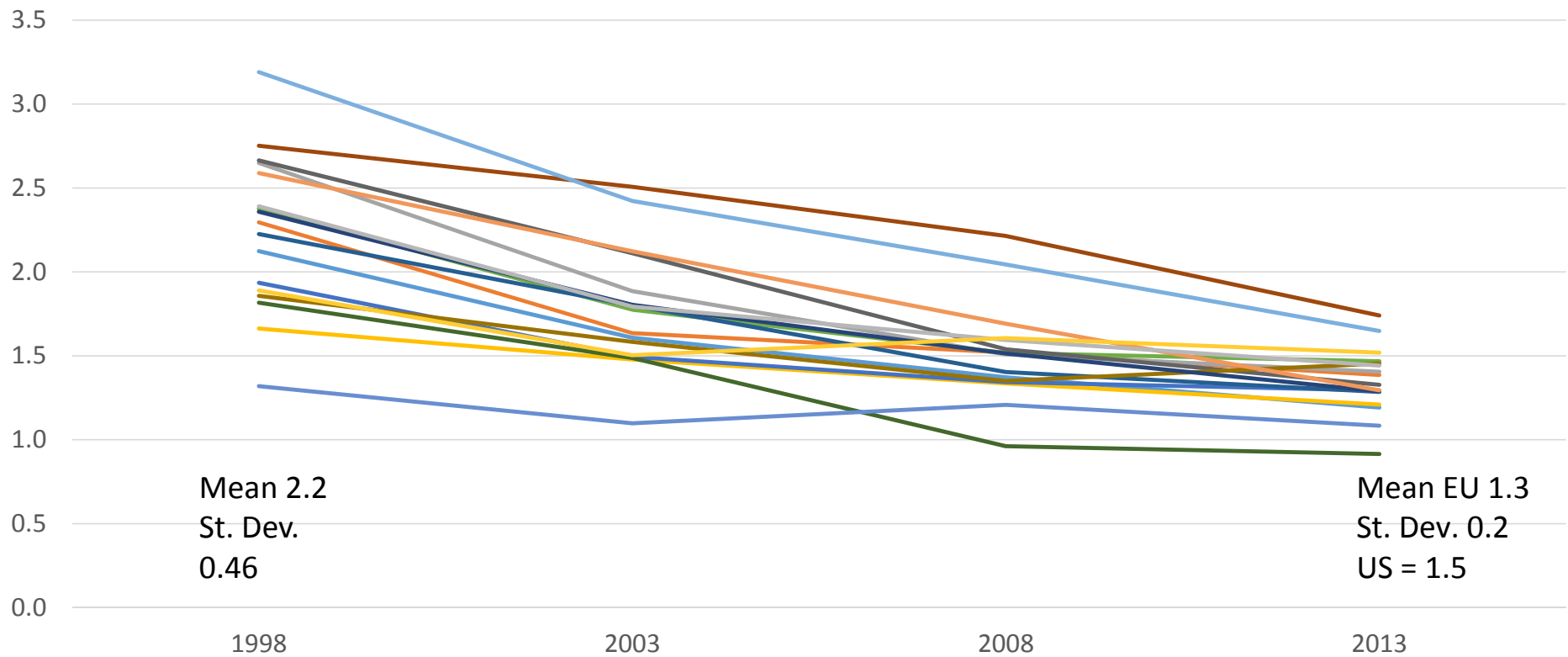




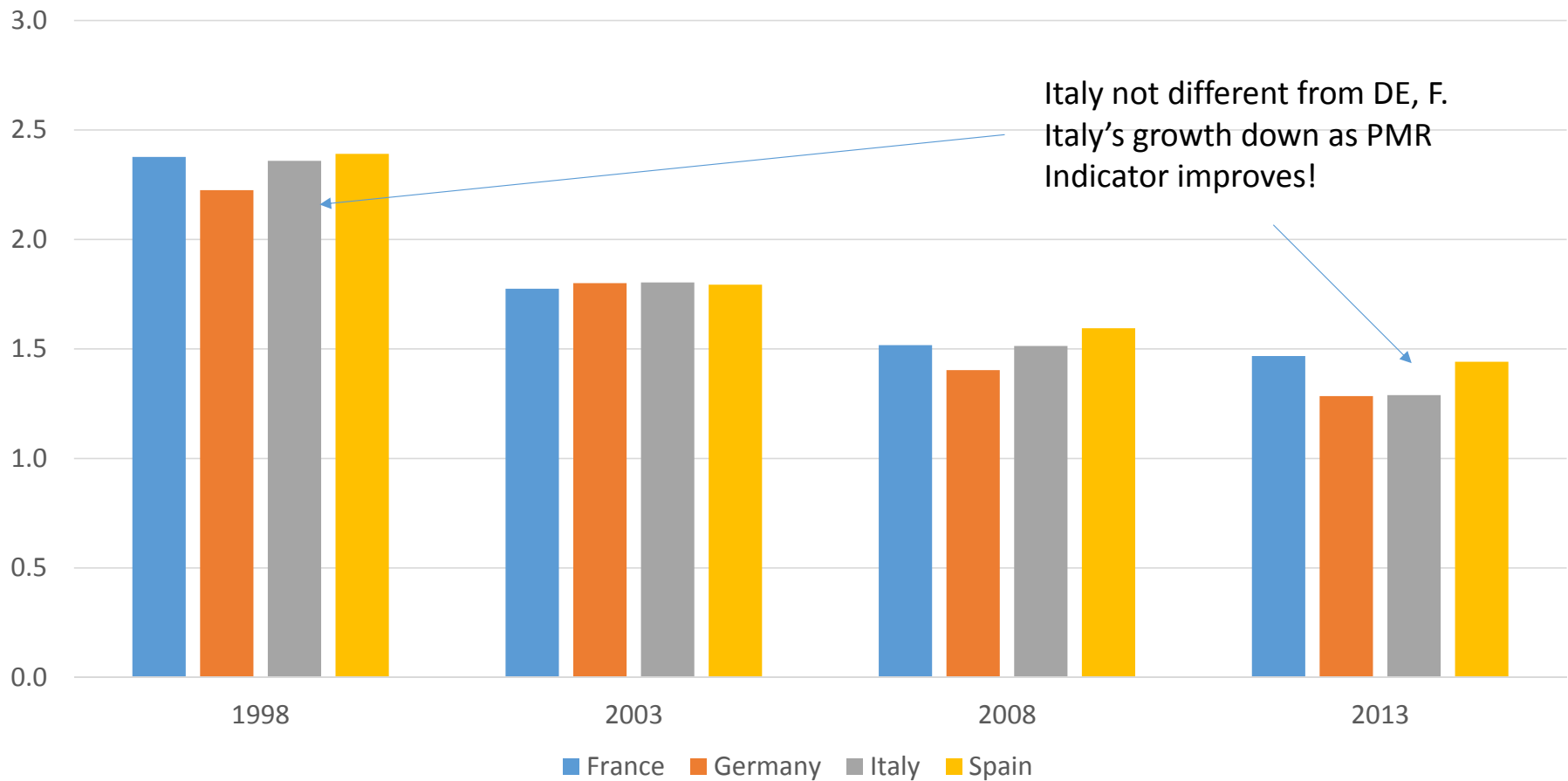
### 3) Do structural reforms make a difference?

- Difficult to measure reforms.
- OECD indicators (Product Market Regulation): big improvement in Europe!
- Labour market indicators (Strictness of Employment Protection) almost no change measured since 1990s.
- Both OECD indicators: measures law and regulations on statute book
- Implementation key, but even more difficult to measure.
- Survey based indicators (e.g. WEF, more recent) suggest little change.

# Convergence of PMR indicator within the EU

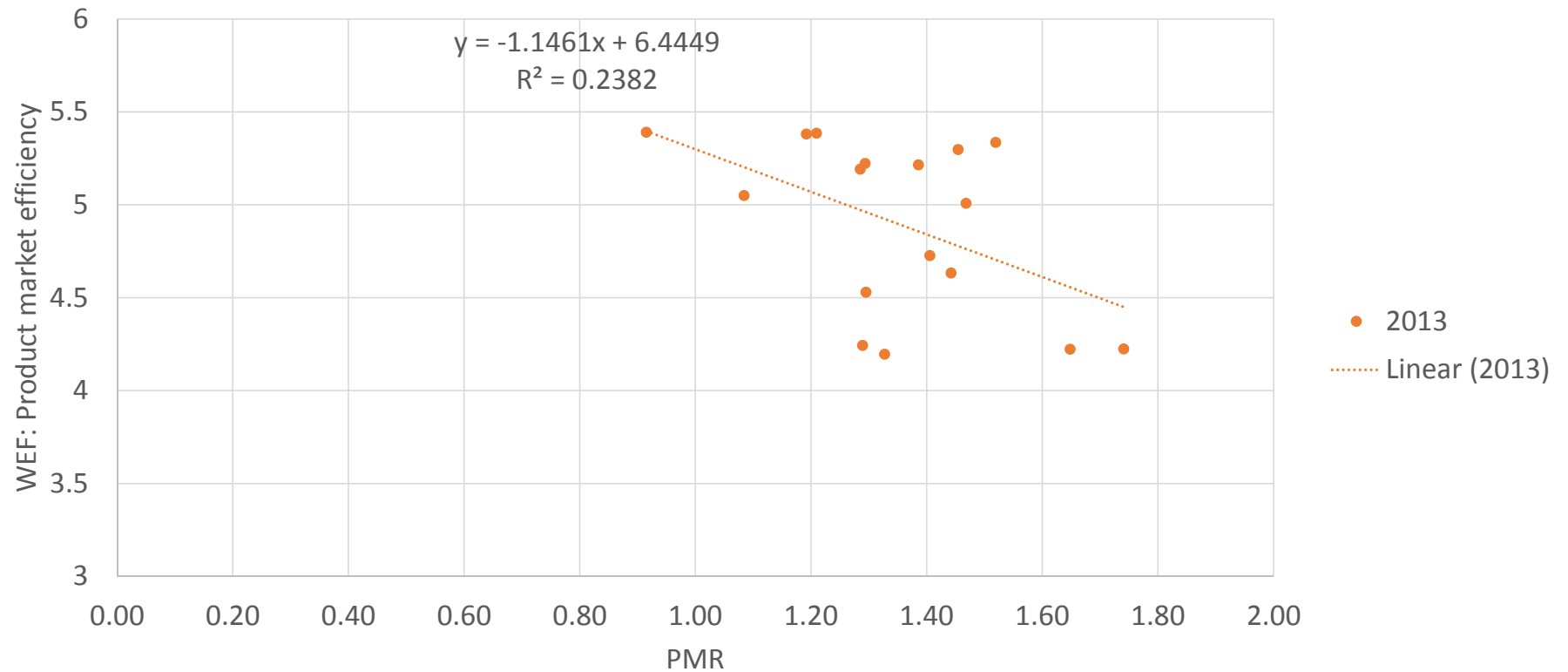


# PMR little difference among 'big' EA

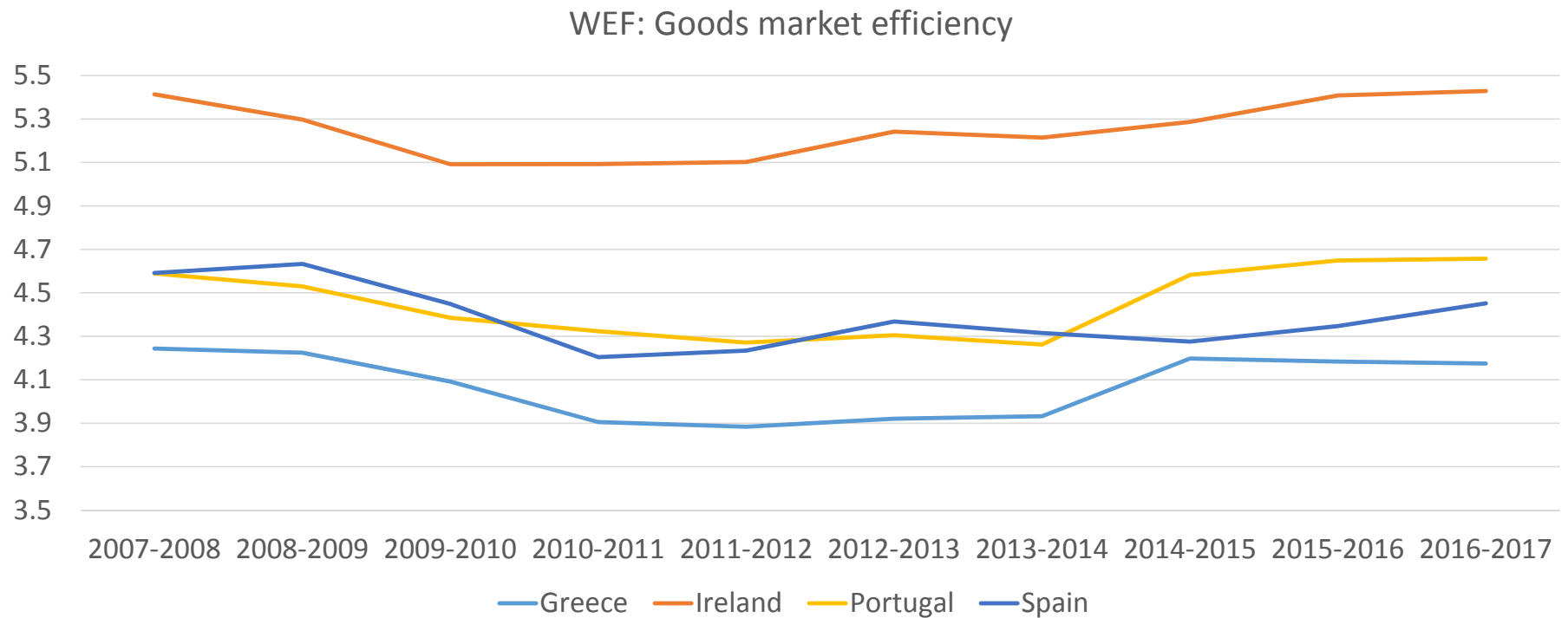


# SR indicators: WEF (survey) vs PMR (formal)

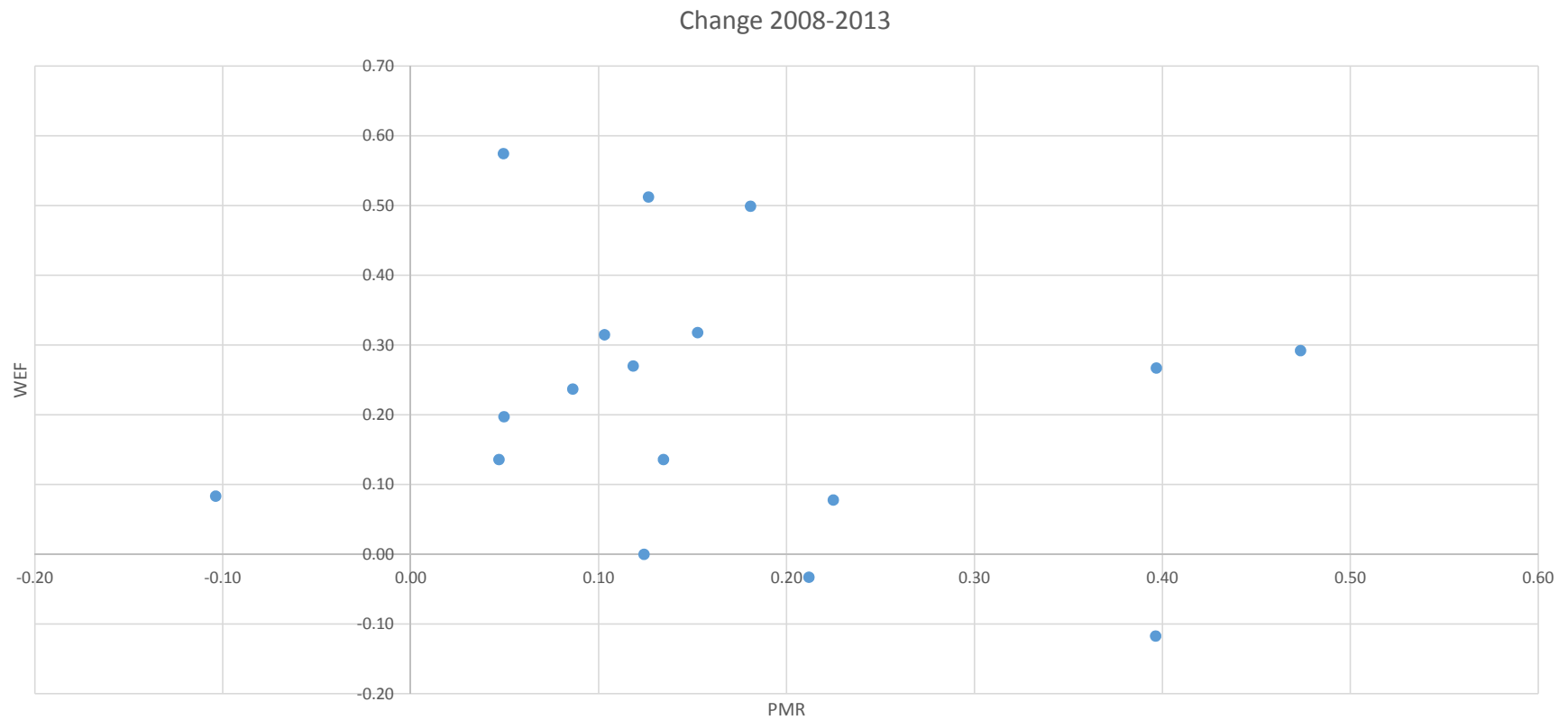
2013



# Program countries: little to no improvement



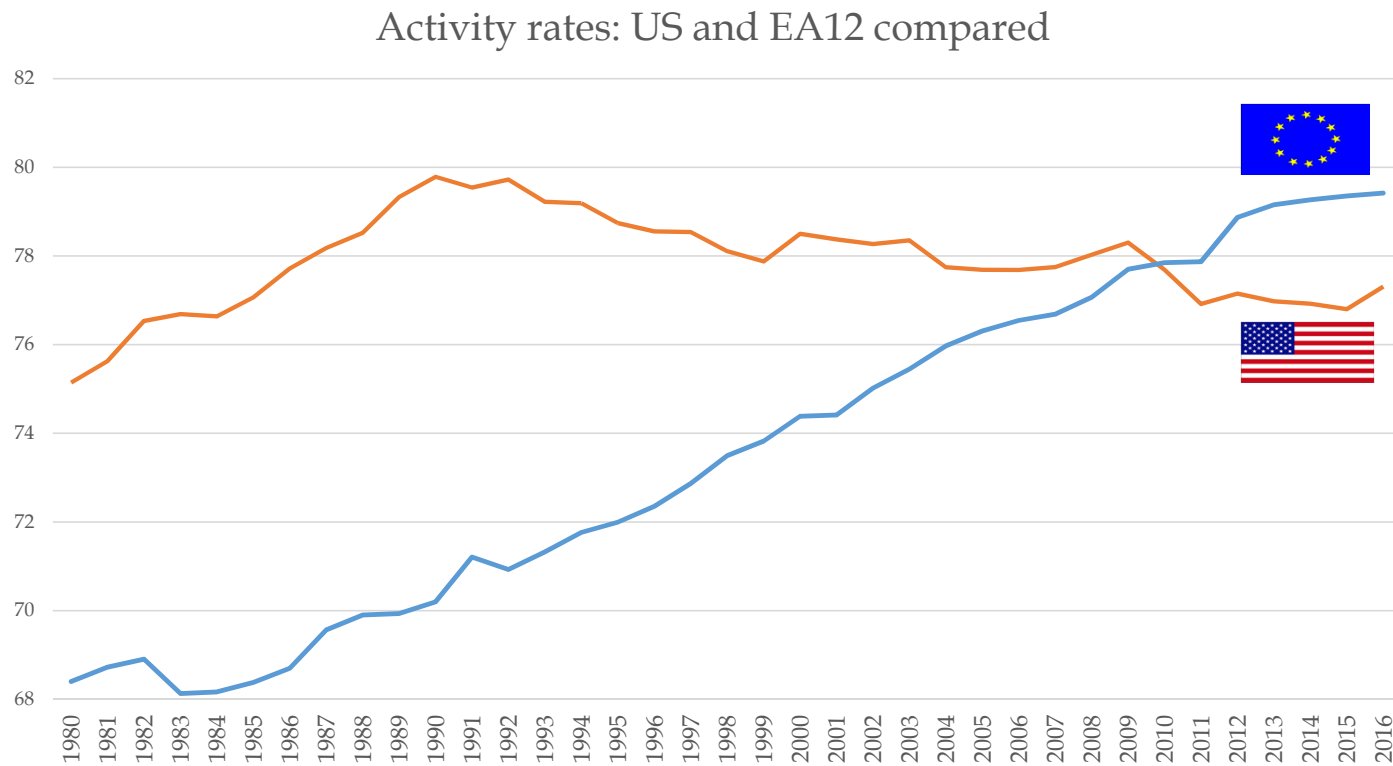
# How to measure 'reforms'? Change in indicators, no correlation WEF and PMR



# Labour markets: the bright spot

- Huge improvement in participation rates
- But virtually no change in OECD or WEF indicators!

# Euro area labour market improves (despite no reforms (no change in OECD/WEF indicators))





# Conclusion

- Beware of the 'structural reforms' mantra.
  - Spill-over effects uncertain.
  - Very difficult to measure reforms
  - => little need coordinate reforms.
  - Little evidence that (as measured) huge reforms increased productivity.
  - Huge improvement in EU (EA) labour market without (measured) reforms.
- => Difficult to link Structural Reforms to Eurozone governance.

P.s. Does human capital (education) make a difference?

- Big progress made since 1970s.
- Europe continues to catch up on all fronts relative to US.
- Average years of schooling (now close to 2/3 of US level).
- Proportion of labour force with tertiary education (key for innovation): EU close to half of US level.
- Result: EU falls further behind.

