THE GROWTH IMPACT OF STRUCTURAL REFORMS

Economic Policy and Business Activities

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STRUCTURAL REFORMS

Driven by:

- Financial and Sovereign Crisis
- Unemployment Rate Very High
- Vulnerable Countries

Intend to boost an economy's:

- Growth potential
- Competitiveness
- Adjustment capacity

QUANTITATIVE ASSESSMENT → POTENTIAL MACROECONOMIC IMPACT OF STRUCTURAL REFORMS IN SELECTED CORE AND VULNERABLE PERIPHERY MEMBER STATES

Focus of the text:

4 largest euro-area countries:

- Germany
- France
- Italy
- Spain

3 programme countries:

- Portugal
- Greece
- Ireland

Model used in this exercise:

- Semi-endogenous growth version of the **QUEST model-** analysing structural reforms.

The model follows QUEST3 and includes EU Member States individually and the rest of the world as a single separate region.

II.1. METHODOLOGY

- Market competitions and regulation
- R&D expenditure
- Skill structure
- Tax structure
- Labour market participation
- Unemployment benefit 'generosity'
- Active labour market policies

Gap between Member States and the 3 best-performing ones in each reform areas considered

Main macroeconomic variables:

- GDP
- Employment
- Trade balance
- Government balances

Spillovers

- Demand's
- Competitiveness effect
- International financial flows
- Knowledge's

Results considered as an upper limit

- Benchmarking approach shows the *potential* that reforms could deliver.
- The indicators used in this exercise are based on the most recent available data.

It takes time before the reform measures have a visible impact on structural indicators (delays).

Reforms are implemented gradually

II.2. STRUCTURAL REFORMS

1. Market Competition and Regulation
    - Negative mark-up shocks in services
    - Reducing entry barriers for start-ups in manufacturing

2. Tax Reform
    - The burden of taxation is shifted from labour income to consumption, boosting employment.

3. Unemployment Benefit Reform

- Reduction in benefits and wages
- Increase of labour supply

⇨ highly felt by the low-skilled and liquidity-constrained households

4. Other Labour Market Reforms

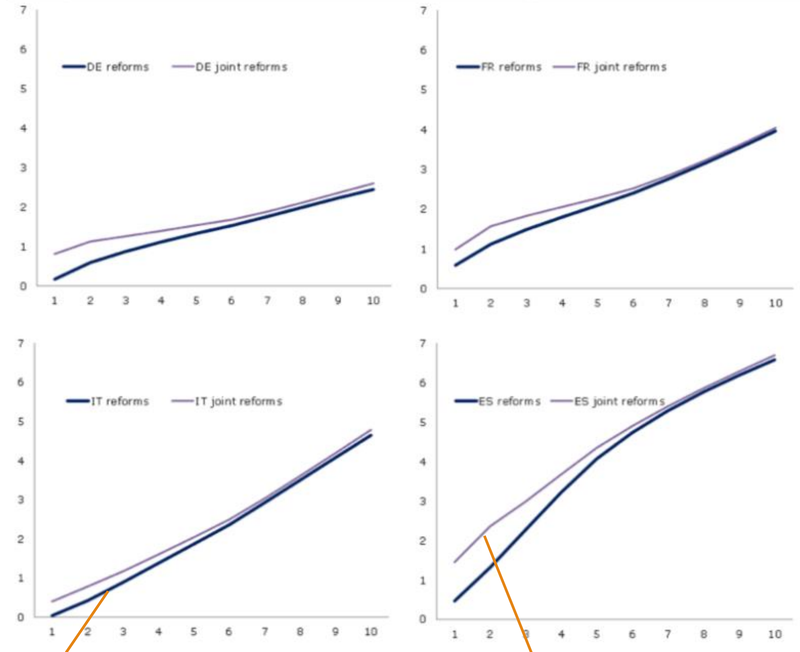
- Rising participation rates for:
  - Women
  - Low-skilled male workers
  - 60-64 year olds
- Active Labour Market Policies (ALMPs)

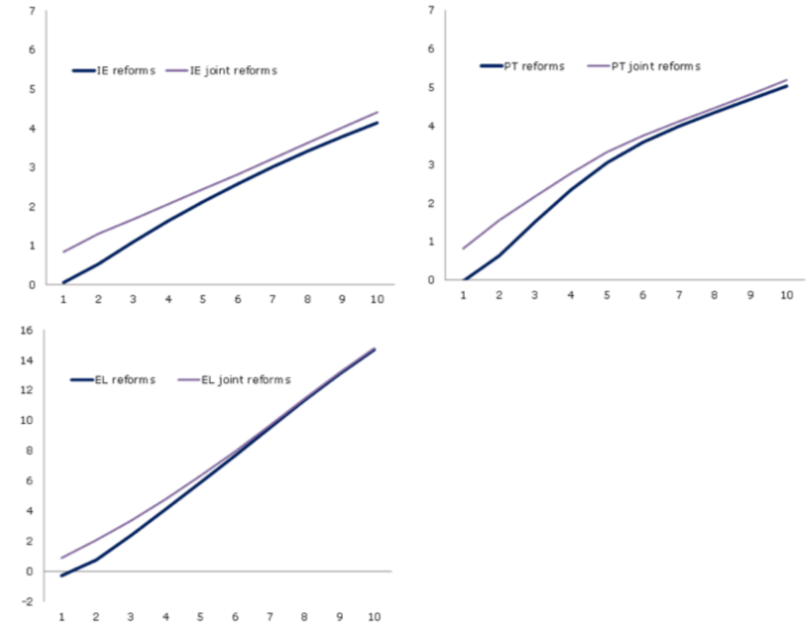
5. Human Capital Investment
    - Based on changes in different skilled categories
        - Quality of education
        - Quality of labour force

6. R&D Investment
    - Policy can affect R&D (e.g. R&D tax credits)
    - Positive effects on GDP in the long-run

MACROECONOMIC IMPACT OF STRUCTURAL REFORMS – MODEL-BASED RESULTS

Graph II.1: **GDP effects structural reforms : acting alone vs. simultaneous reforms (1)**



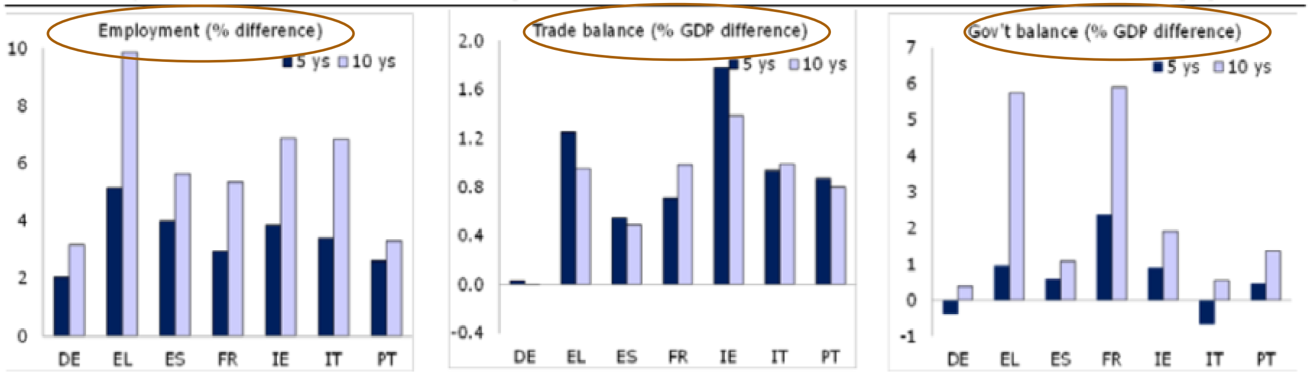


(1) Percentage difference from baseline.
Source: QUEST simulations.

1st: go throw the model for each country separately

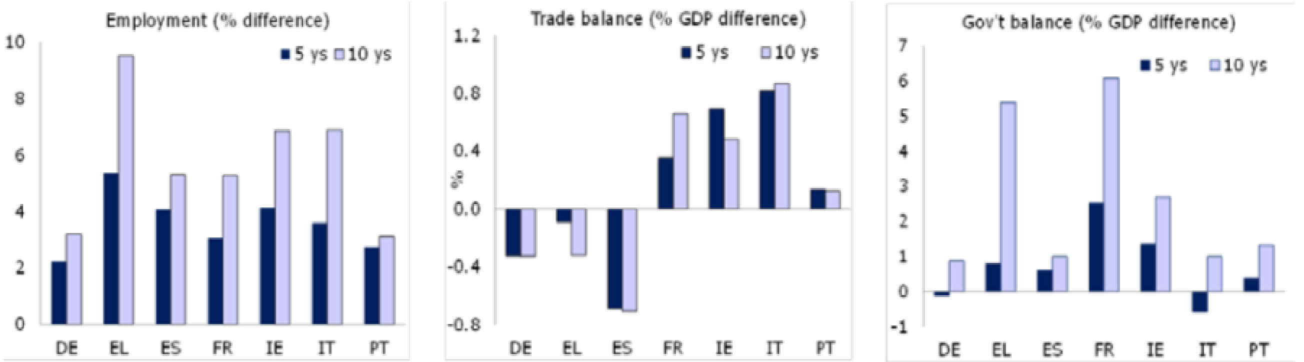
2nd: spill over are taken into account

Graph II.2: **Macroeconomic impact structural reforms: Stand-alone reforms (1)**



(1) Percentage point difference from baseline.
Source: QUEST simulations.

Graph II.3: **Macroeconomic impact structural reforms: Joint reforms (1)**



(1) Percentage point difference from baseline.
Source: QUEST simulations.

IMPACT OF STRUCTURAL REFORM IN EACH COUNTRY

Greece: largest gains by

- Improving competition and reducing entry costs;
- Increasing labour-force participation;
- Improving labour-force skills;
- Boosting R&D

→ Can raise GDP by 6% after 5 years and almost 15% after 10 years

Higher Growth → More tax revenue and less transfer payments, improving Government Budget Balance (more than 5% of GDP)

IMPACT OF STRUCTURAL REFORM IN EACH COUNTRY

Portugal by
- Improving competition and reducing entry costs;
- Shifting tax burden from labour to consumption.

→ Can raise GDP by 3% after 5 years and almost 5% after 10 years

Ireland by
- Skill enhancing changes;
- Increasing labour-force participation.

→ Can raise GDP by 4.5% after 10 years and employment 6,8%

Spain by
- Improving market competition;
- Shifting burden further than labour taxation to less distortionary taxes (example: consumption).

→ Can raise GDP by 4.4% after 5 years and 6.7% after 10 years

IMPACT OF STRUCTURAL REFORM IN EACH COUNTRY

France by
- Shifting burden further than labour.
- Increase the participation rate among older

workers by raising the effective retirement age (60-64 group)

→ Can raise GDP by 6% after 10 years

Italy and Germany by:
- Entry costs for the new firms;
- Increase the participation rate of inactive population
- Policies promoting R&D

→ Italy can raise GDP by 4,8% after 10 years* and Germany 2,6%.

SPILLOVERS:

“Acting Alone” scenario: Impact on trade balances is positive (Graph II.2)

VS

“Simultaneous Reform” scenario: GDP effects are better in this case (Graph II.1)

CONCLUSIONS

- Large potential gains could be reaped from structural reforms.
- Increase in the Euro-area's GDP.
- The reforms package should not be seen as unrealistic nor overly ambitious for Member States.
- Delays in reforms' implementation would lead to smaller effects in the first few years.
- Although the effects in the short term are small, product markets' reforms can lead to large output gains over time.
- Reforms lead to significant improvements in many areas in the medium/long term.

CONCLUSIONS

Comparing graph II.2 and graph II.3:

- Macroeconomic impact of structural reforms in the 3 areas considered:

➢ **Employment:** positive impact of the reforms both in the case where they act alone and in the case where they act in simultaneous with other reforms (joint reforms).

➢ **Trade Balance:** negative impact of the reforms when we consider the joint reforms case. The % of GDP difference is low and even negative when we simulate reforms implemented together. This must be due to the demand spillover and the competitiveness effect of joint reforms.

➢ **Government Balance:** in some countries the government balance is slightly negative because of the reforms assumed to be implemented. These have large costs in the beginning but result in more effective results.