

STRUCTURAL REFORMS IN EUROPE: POLICY LESSONS FROM THE CRISIS

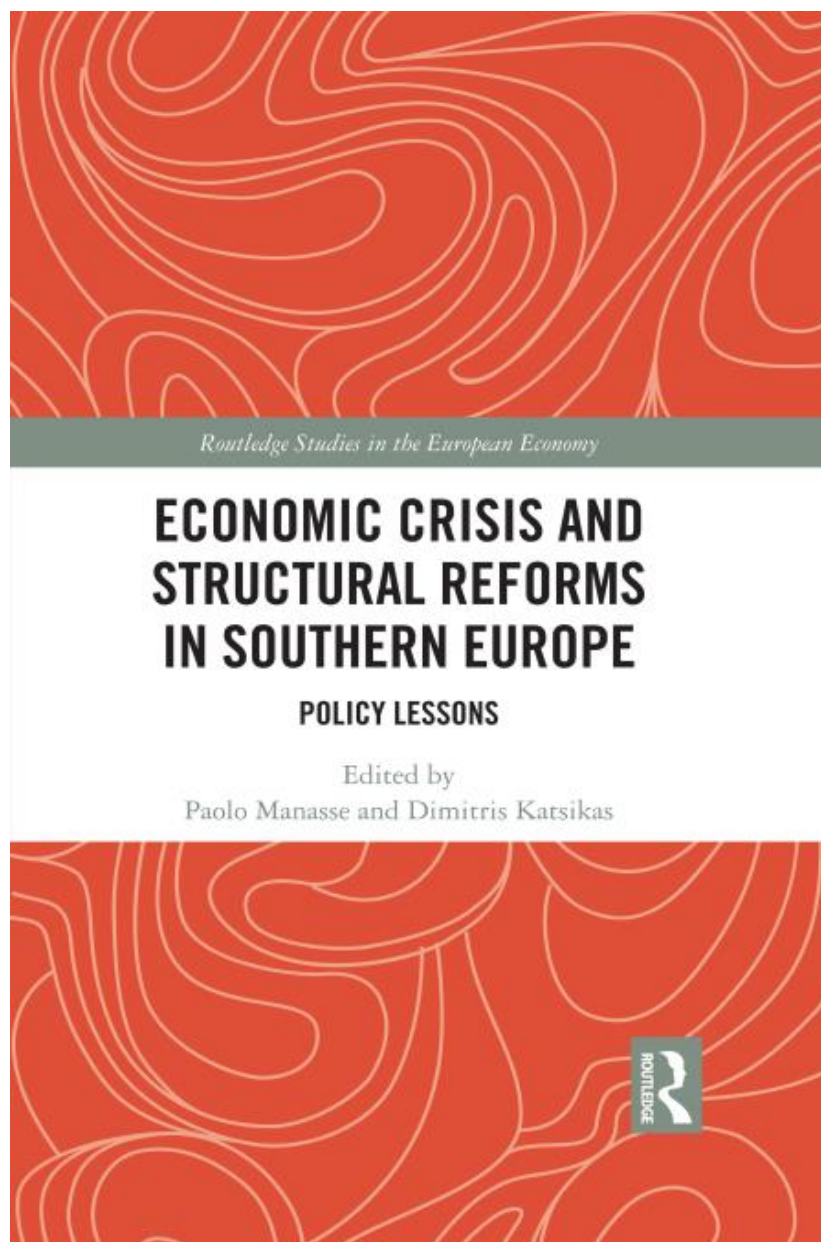
Paolo Manasse
University of Bologna

BRUEGEL, BRUXELLES, 18 SEPTEMBER 2018

Political Economy and Design

Labour, Product, Banking Sector
Reforms in Spain, Portugal,
Greece, Cyprus

Edited with D Katsikas with
contributions from Otero-
Iglesias, Steinberg,
Panagiotarea, Clerides,
Petralias, Anastasatou, Geli,
Herrero, Turrini, Catao,
Aksoy, Terzi



Policy Lessons:

Large Heterogeneity of Institutions, Economic Conditions, Gov. Orientation/competence, History

What conditions for successful implementations and main obstacles?

What characteristics of policy design and implementation were crucial for success?



Crucial Elements for Success/Failure

1. Delay
2. Ownership
3. External Constraints
4. Timing
5. Balance Fiscal Consolidation/Reforms
6. Sequencing

1.Delay

- Economic Crises may happen over-night but result from decade-long imbalances
 - productivity growth (Portugal, Greece, Italy)
 - Institutions in Collective Bargaining, hiring/firing (Portugal, Greece, Spain, Italy)
 - Entry Barriers / bureaucracy product markets (Greece, Portugal)
 - Inefficient supervision, nepotistic corporate governance/political interference (Cyprus, Greece, Spain, Portugal)
- => longer the delay in reforms the worse (large resistance, NPL, unemployment, credit crunch, recap costs)

2. Ownership

Delay -> perverse Illusion : Obsolete institutions are fine, and Reformers are to blame

- Example: Italy (Jobs'Act), Greece, Spain (Banking), Cyprus (CB/Gov conflict on recapitalization) . No consensus
- Counter example: in Portugal (Banking, and Labor), Spain (Labor) public awareness, history of partial reforms

3. External Constraints

- Scapegoat role?
- IFI enforcement power has limits with Reforms (particularly EU compared to IMF) , poor substitute for ownership (implementation, banking resolutions in Greece)
- ..but lack of it can be detrimental (Cyprus and Russia, Spain delayed bank-bailout)
- Micro-management ineffective (Portugal labor reforms)

4. Timing of Reforms

- Crisis are catalyst for Reforms ?
 - No if the economy has already deteriorated as social consensus impossible (political constraint)
- Example: Greece's lack of early debt relief and harsh fiscal consolidation played in the hands of anti-reformers
 - Yes early recession forces consensus. Example Portugal and Spain labor reforms + ownership

5. Balance Fiscal /Structural Reforms

- Often positive effects of SR swamped by Fiscal Consolidation

Examples:

- product market reforms in Greece: prices, employment
- Trade-off of Reforms: resilience (impact)/speed of recovery (dynamics) in Labour Markets

Greece, 2005-15 Product Market Reforms and GDP Employment, Quarterly Data

Table 1: Stepwise Regression for employment

Variable

C	-0.009	(-4.07)***
DUMMY_Q1	0.018	(5.74)***
DUMMY_Q2	0.011	(2.11)**
DUMMY_Q3	-0.002	(-0.46)
EMPLOYMENT(-1)	0.553	(6.09)***
GDP_VOLUME	0.144	(3.48)***
DUMMY_OECD_TOOLKIT(-3)	0.021	(3.44)***
DUMMY_OECD_TOOLKIT	0.014	(2.36)**
PRIVATE_LOANS	0.076	(1.92)*

R² adjusted 0.85

Notes:

1. The values in the parenthesis are t-statistics.
2. The set of candidate predictors are presented in Appendix I.
3. Selection method: Stepwise forwards, Stopping criterion: p-value forwards/backwards = 0.05/0.05
4. *Statistically significant at the 10 percent level. ** Statistically significant at the 5 percent level. *** Statistically significant at the 1 percent level.
5. **EMPLOYMENT** corresponds to the number of employed persons, **DUMMY_Q1-Q3** to seasonal dummies for first, second and third quarter, **GDP_VOLUME** to Gross domestic product at market prices, **DUMMY_OECD_TOOLKIT** to dummy for the legislation of the OECD toolkit (taking value one in 2014 Q3) and **PRIVATE_LOANS** to total amount of private loans provided by private banks. All variables (except dummies) were converted to indices with year base 2010=100, and log differences were taken.

Greece, 2005-15 , Product Market Reforms and Tax Rise Prices, Quarterly Data

Stepwise Regression for CPI

Variable

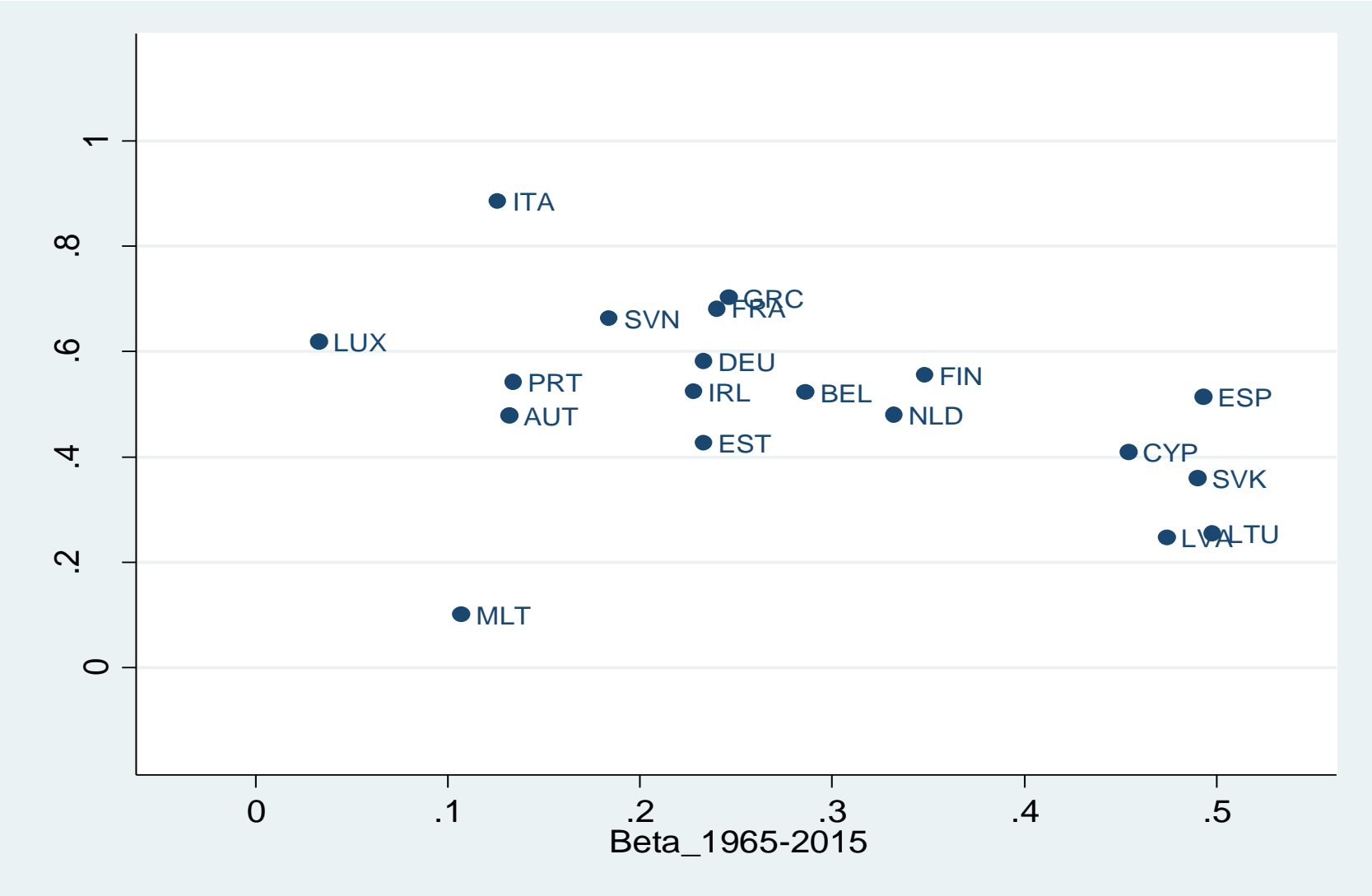
C	0.019	(12.12)***
DUMMY_Q1	-0.031	(-10.55)***
DUMMY_Q2	-0.000	(-0.16)
DUMMY_Q3	-0.039	(-11.80)***
CPI(-1)	0.424	(4.30)***
DUMMY_OECD_TOOLKIT(-1)	-0.018	(-3.93)***
MINIMUM_CAPITAL_ANONYMOU	0.018	(3.52)***
SPECIAL_FUEL_TAX_UNLEADE	0.045	(3.50)***
EUROPE_BREND_SPOT	0.011	(2.59)**
DUMMY_ELECTIONS	0.003	(1.99)*

R² adjusted 0.91

Notes:

1. The values in the parenthesis are t-statistics.

Unemployment: Trade-off impact (beta) and persistence (alpha) of shocks



6. Sequencing

- **POLITICAL CONSTRAINTS:** Political Capital is limited and should not be dissipated
 - concentrate on «bottle-necks» to growth
 - Labour Mkt Reforms in Portugal: ownership
 - Labor Mkt Reforms in Greece: less resistance
- **SOCIAL/FAIRNESS CONSTRAINT:** distribution of burden
 - Greece: lack of priority of product market reforms, focus on labor and fiscal, real wages, aggregate demand, lack of productivity and competitiveness

The End

Data

- Unemployment and GDP gap data cover the year between 1965-2015.
- Data on labor and product markets, 19 EUZ countries, 1965-2013.
- Product Market: OECD's Product Market Regulation (PMR) Dataset , 1975-2013
- Labor Market: OECD's Employment Protection Legislation Dataset (EPL), 1985-2013
- ICTWSS's Centralization of Wage Bargaining (CWB) Dataset, 1965-2014.
- Each indicator varies between 0-6 with higher values corresponding to more regulation.

Empirical Analysis

- First step: Basic estimation equation

$$u_{it} - u_{it}^p = \beta_i(y_{it} - y_{it}^p) + \alpha_i(u_{it-1} - u_{it-1}^p) + v_{it} \quad (1)$$

- Second Step: Assume

$$\beta_{it} = \beta_0 + \beta_1 IND_{it} \quad \text{and} \quad \alpha_{it-1} = \alpha_0 + \alpha_1 IND_{it-1}$$

Substituting:

$$\begin{aligned} & u_{it} - u_{it}^p \\ &= (\beta_0 + \beta_1 IND_{it})(y_{it} - y_{it}^p) + (\alpha_0 + \alpha_1 IND_{it-1})(u_{it-1} - u_{it-1}^p) + (c_0 + c_1 IND_{it}) + v_{it} \end{aligned} \quad (2)$$

Figure 7: Counterfactual analysis for Greece

