

Labour Markets and Structural Reforms (in the EU)

Regulation and flexibility

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Aims

- Take stock (*critically*) of what economists have learned re structural reforms
- Emphasis on the role of integration (chiefly EU)
- Key motivation is that structural reforms are central element of recovery strategy

Defining reforms

- Structural reforms refer to policies that alter fundamentally the way the economy is organized
- Structural reforms “unholy trinity”
 - Product market reforms (PMR)
 - Financial market reforms (FMR)
 - Labour market reforms (LMR)
- Examples
 - Deregulation of product markets and other initiatives to increase competition
 - Measures aimed at making labour markets more flexible
 - Policies to make use of financial resources more efficient and equitable

Defining reforms

1 - This list can be broadened

- policies for the opening up of the economy to trade, finance and FDI
- privatisation

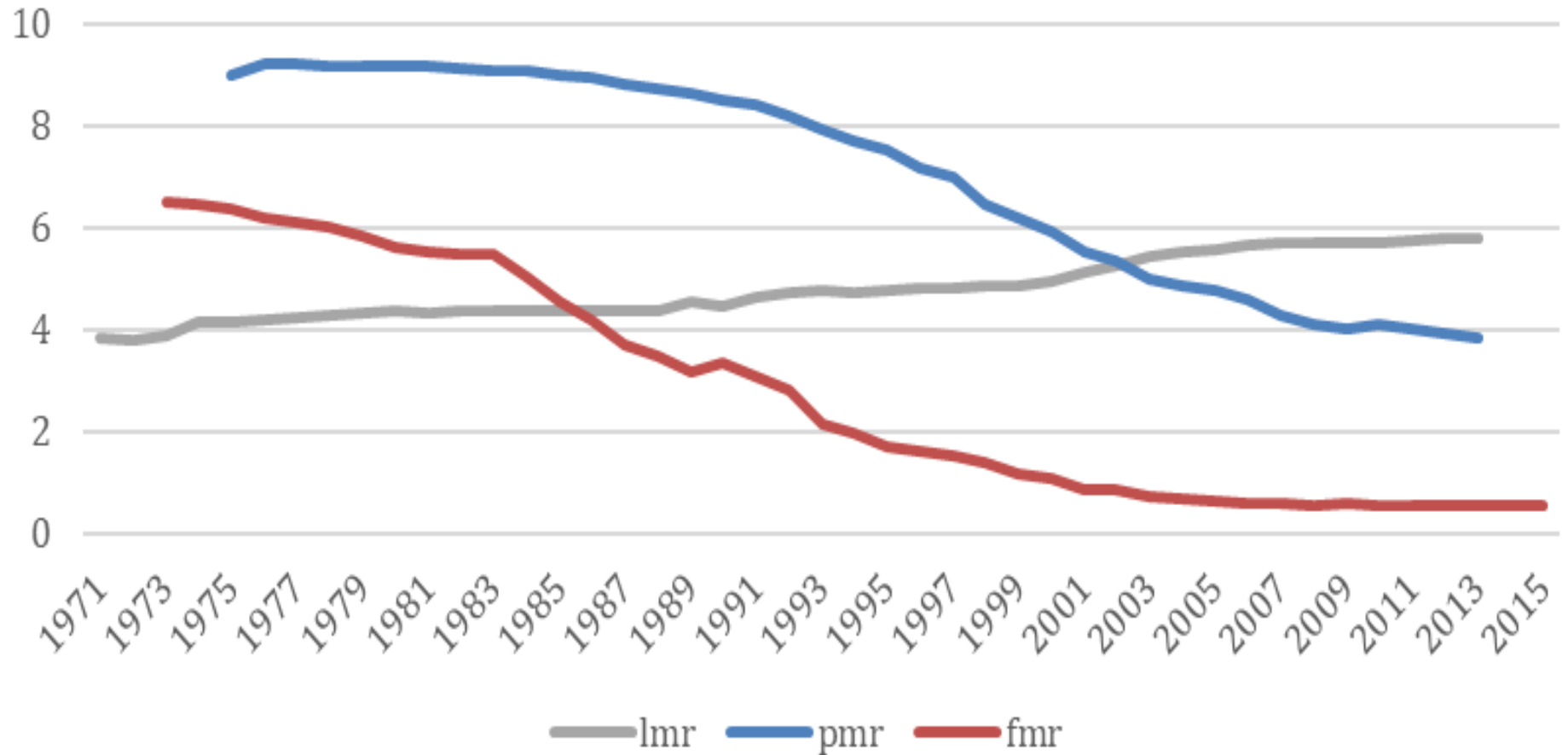
2 - DG Reform provides technical support in 5 areas:

1 FMR, 2 PMR, 3 LMR,
plus 4 governance, and 5 public finance

3 - Emphasis here is on Domestic Policy Effort

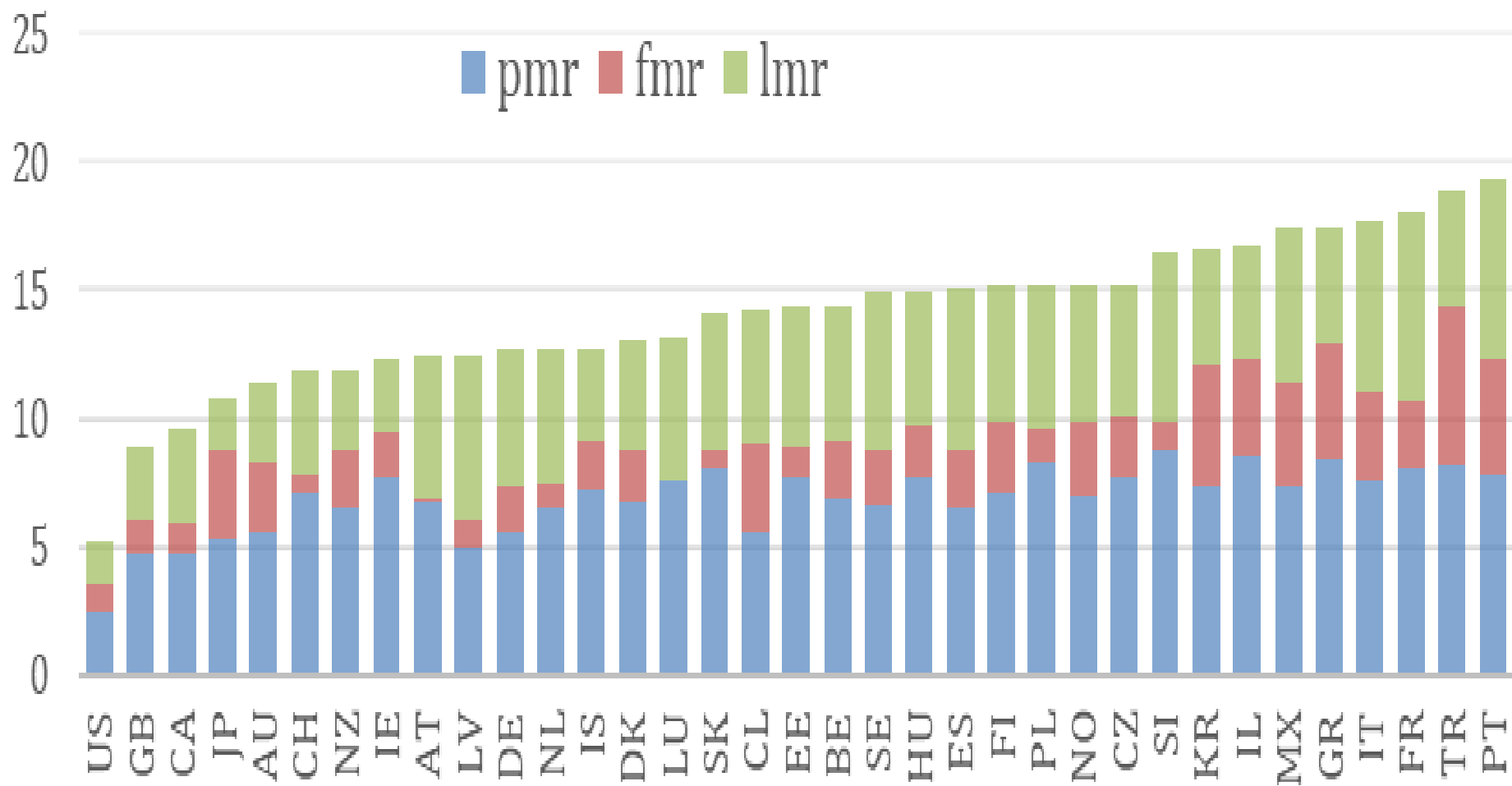
Some (couple) stylised (motivating) facts (trends)

FIGURE 1: AVERAGE PRODUCT, FINANCIAL AND LABOR MARKETS
REGULATION INDEX: 1971-2015



Source: Constructed using OECD data and the methodology developed and explained in Campos, Eichenauer and Sturm (2020).

**FIGURE 2: PRODUCT, FINANCIAL AND LABOR MARKETS
REGULATION INDEX: COUNTRY AVERAGE 1971-2015**



Outline

- What do we know about this Unholy Trinity of reforms?
- Has European integration helped the implementation of LMR, FMR and PMR? Whither integration (did the euro help?)
- What are productivity effects of these reforms in the EU?
- What do we ought to do next? Identification and measurement

**What do we know about
this Unholy Trinity
of reforms?**

Product market reforms

- Loads of evidence wrt PMR on growth but...
- Intense debate about channels
- Effects of PMR on competition?
Philippon and Gutierrez: Concentration
- Effects of PMR on innovation?
Aghion et al Inverted U

Financial market reforms

- Loads of evidence wrt FMR on productivity
(especially at firm level) but...
- Intense debate about mechanics
- Effects of FMR on stability?
- On the nature of financial liberalisation policies
 - role of public vs. private sector in pushing reforms
 - difficult to identify reform effort
 - what role for financial globalisation and IOs?

Before Labour market reforms, 2 issues

- **Timing = *Business cycles considerations***

- Why are reforms often implemented at the worst possible moment, i.e. recessions? (Furceri et al)
- Reform reversals and bundling (G. Roland)

- **Context = *Political economy considerations***

- Inequality
- Democracy
- Crisis

Duval et al JAE 2021: crisis is key/BAMLE determinant
Gokmen et al EJ 2021: crisis does not lead to reforms
(indeed in autocracies crisis lead to reform reversals,
although not the case in democracies)

Labour market reforms: 4 reasons

- LMR are difficult to design, implement and, indeed, to understand.
1. This may be because LMR covers a very wide range
 - employment protection legislation
 - unemployment benefits
 - minimum wages
 - Labour taxes
 - social security
 - pensions
 2. Plus effects of LMR are broader than PMR and FMR
 3. Plus LMR are heatedly and extensively debated, often approved in bundles with implementation lags
 4. Complementarities with other reforms?

LMR and growth, u and other refs

- LMR and growth relationship remains very contentious
 - Is it non-linear? Belot and van Ours (2007)
- LMR and unemployment
 - The key issue here seems to be which LMR dimension
- LMR and other reforms
 - LMR and PMR, LMR and FMR, LMR and taxes

**Has European integration helped
the implementation of labour,
financial and product market
reforms?**

*Whither integration?
Does the euro help?*

Does integration drive structural reforms?

- Structural reforms: policy-makers seem to love them, academics maybe not so much
- Structural reforms not big in USA, but are in Europe
- Does the euro (and or the Single Market) help or hinder the implementation of structural reforms
- in terms of labour, finance and product markets (reforms) ?

Why should the ESM matter for reforms?

- ESM on product market regulation
 - Legal framework to increase trade and competition
 - Supra-national competition policy to rule against state aid and monopolistic practices
- Labor market regulation
 - Indirect effect via increased competition in tradables

Why should the Euro matter for reforms?

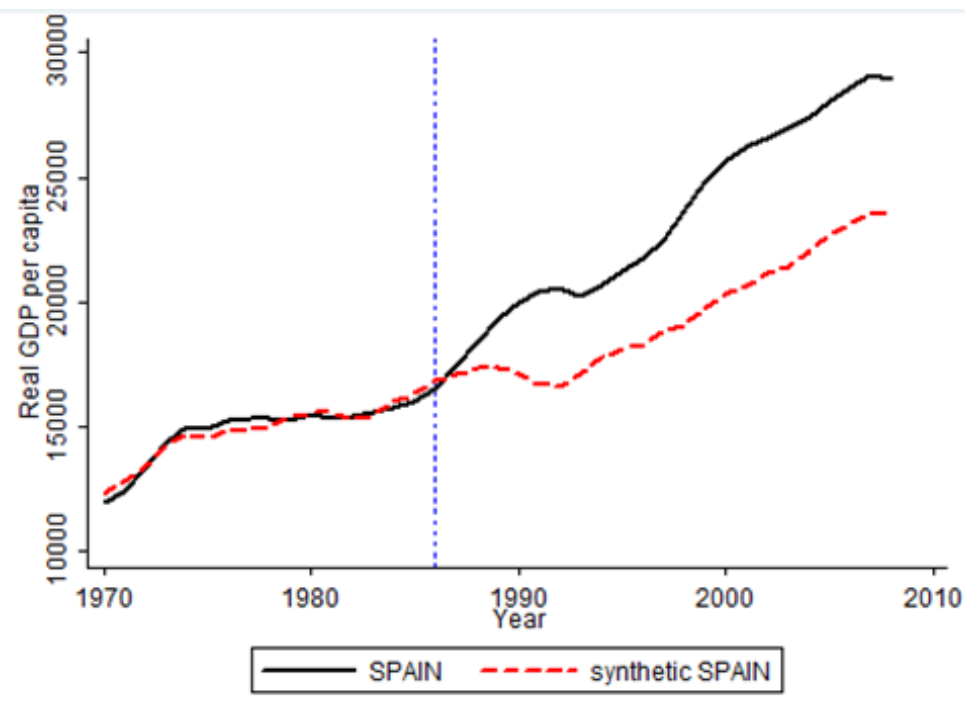
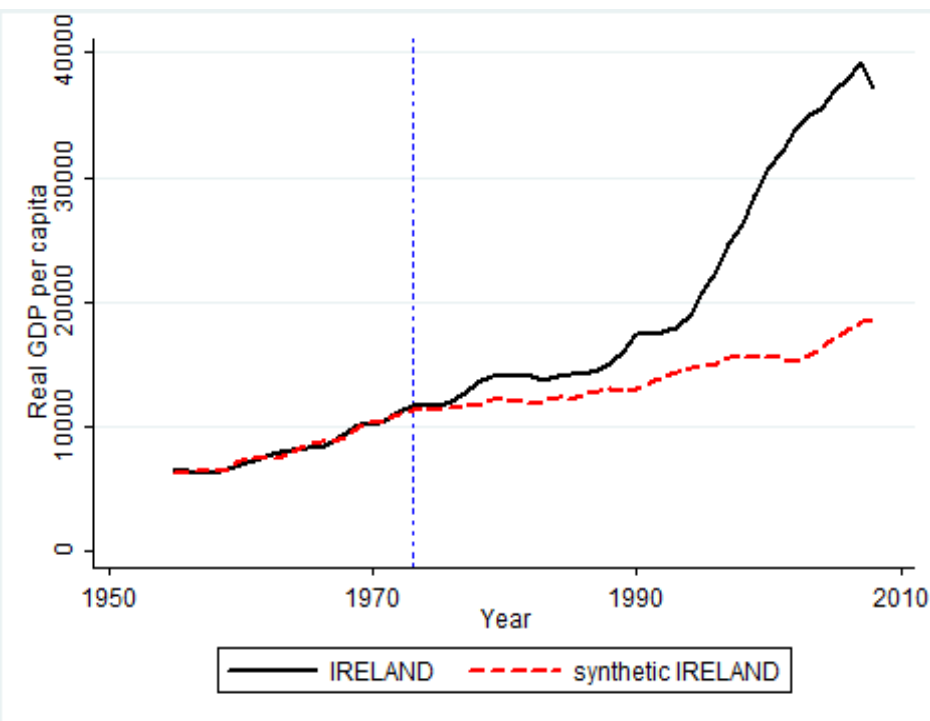
- Relinquishing monetary policy (no more competitive devaluations) requires liberalization of labour and product markets
- Common currency increases price transparency and reduces transactions costs. This should increase trade and competition.
- Product Market: Effects on tradable sector put pressure for upstream deregulation.
- No monetary autonomy / no strategic devaluation
 - Product market: Loss of competitiveness increases demand for deregulation
 - Labor market: Wage growth > productivity growth increases demand for deregulation
- “Political tool” to promote product market reform agenda

Why should the Euro *not* matter?

- Up-front cost of structural reforms increases: less expansionary aggregate demand possible to counteract the effects of structural reforms on the supply side (Saint-Paul and Bentolila 2000)
- Political resistance to more flexible labour markets (Obstfeld 1997)

Can we disentangle SM from Euro?

Illustrated by Ireland vs Spain



Source: Campos Coricelli Moretti 2019

The Literature on Euro, ESM and Reforms

Literature: ESM / Euro on PMR and LMR

- Duval (2006): Macroeconomic policy on structural reforms
- Duval and Elmeskov (2006): Monetary policy on structural reforms
- Bugamelli, Schivardi and Zizza (2010): Euro and firm restructuring/PMR

- **Alesina, Ardagna & Galasso (AAG)**

- Bednarek-Sekunda, De Haan and Jong-A-Pin (2010):
 - Euro on labor market flexibility
- Galasso (2014):
 - Crisis fosters PMR but not LMR, Euro has bigger effect than ESM
 - Euro has heterogeneous effects on LMR and PMR; little to no effect of ESM
- Schönfelder (2018):
 - Euro fosters PMR liberalization

Academic Literature:

Single Market & Single currency on PMR/LMR

- Duval & Elmeskov (2006)
 - euro little effect on PMR/LMR
- Alesina, Ardagna & Galasso (2005, 2011)
 - euro foster PMR, no effect on LMR
 - ESM foster PMR, no effect on LMR
 - euro effect bigger (3x) than Single Market
- Schönfelder (2019)
 - euro (more than OECD) fosters PMR liberalization

Alesina, Ardagna and Galasso (AAG) 2011

- “The Euro and Structural Reforms”
- Have members of the euro area had a better policy performance after adopting the common currency?
- Policy performance = (1) labour, and
(2) product markets’ liberalization and deregulation

AAG: Product Market

- Product Market: OECD Regulatory (anticompetition) indicators for 7 non-manufacturing industries (electricity, gas, telecom, post, airlines, road freight, railways)
- measuring Barrier to Entry & Vertical Integration, Market Structure, Price controls, Public ownership
- aggregated in 3 sectors: Energy, Communication & Transportation
- 21 OECD countries in 1975-2003

AAG: Labour Market

- OECD Employment Protective Legislation, measuring (i) severance pay and notice period, (ii) procedural inconvenience, (iii) difficulty of dismissal. Temporary and Regular workers
- Unemployment Benefits: Replacement Rate for low-income workers (2/3 avg income) in 1st year
- 21 OECD countries in 1985-2003

Table 2.1 The euro and product market reforms

	Three Sectors			Five Sectors		
	REG (1)	REG (2)	REG (3)	REG (4)	REG (5)	REG (6)
REG(-1)	0.94 (108.60)***	0.93 (107.10)***	0.95 (104.66)***	0.93 (112.17)***	0.93 (108.13)***	0.95 (104.06)***
ESM	-0.06 (-2.28)**			-0.06 (-2.05)**		
EMU	-0.18 (-5.20)***			-0.15 (-4.83)***		
ESM*ENERGY		0.02 (0.61)	0.01 (0.23)		0.03 (0.70)	0.01 (0.24)
ESM*COMMUNICATIONS		-0.03 (-0.81)	-0.03 (-0.81)		-0.03 (-0.72)	-0.03 (-0.74)
ESM*TRANSPORT		-0.16 (-4.35)***	-0.15 (-4.05)***		-0.16 (-4.32)***	-0.15 (-4.02)***
ESM*RETAIL					-0.26 (-2.07)**	-0.27 (-2.54)**
ESM*PROFESSIONAL					0.22 (2.74)***	0.24 (2.87)***
EMU*ENERGY		-0.43 (-9.07)***	0.04 (0.49)		-0.43 (-8.95)***	0.11 (1.23)
EMU*COMMUNICATIONS		-0.28 (-5.74)***	0.02 (0.31)		-0.29 (-5.79)***	0.06 (0.86)
EMU*TRANSPORT		0.11 (2.39)**	0.46 (6.26)***		0.11 (2.35)**	0.50 (6.98)***
EMU*RETAIL					0.52 (4.16)***	0.85 (5.75)***
EMU*PROFESSIONAL					-0.09 (-1.14)	0.29 (2.94)***
EMU*REG(-1)			-0.12 (-6.24)***			-0.14 (-7.34)***
Observations	1,764	1,764	1,764	1,802	1,802	1,802

Notes: Generalized least squares regressions allowing for heteroscedasticity of the error term and including country, sector, and time dummies. *T*-statistics in parentheses.

REG: indicator of regulatory impediments to product market competition, excluding public ownership; ENERGY, COMMUNICATIONS, TRANSPORT, RETAIL, and PROFESSIONAL: sectorial dummy variable that equals 1 for the corresponding sector; ESM: dummy variable equal to 1 from 1993 onward for the countries that enter the European Union's single-market Program; EMU: dummy variable equal to 1 from 1999 onward for the countries that enter the EMU. Columns (1) through (3) include the following three sectors: ENERGY, COMMUNICATIONS, and TRANSPORT. Columns (4) through (6) include all five sectors in our database: ENERGY, COMMUNICATIONS, TRANSPORT, RETAIL, and PROFESSIONAL. See also the appendix for the exact definition of the variables.

***Significant at the 1 percent level.

**Significant at the 5 percent level.

Euro effect
larger than
European Single
Market

Euro effect
larger when
initial regulation
was larger

Table 2.6 The euro and employment protection

	EMPLOYMENT PROTECTION (1)	EMPLOYMENT PROTECTION (2)	EMPLOYMENT PROTECTION (3)	EMPLOYMENT PROTECTION (4)	EMPLOYMENT PROTECTION (5)	EMPLOYMENT PROTECTION (6)
EMPLOY. PROTECTION(-1)	0.93 (31.35)***	0.92 (31.08)***	0.93 (31.51)***	0.92 (30.70)***	0.92 (30.77)***	0.92 (30.68)***
ESM	-0.01 (-0.87)	-0.01 (-0.95)	-0.02 (-1.07)	0.00 (0.78)	0.00 (0.74)	0.00 (0.74)
EMU	-0.01 (-0.66)	0.04 (0.79)	0.00 (0.04)	-0.02 (-0.89)	0.00 (0.23)	-0.01 (-0.26)
EMU*EMPL. PROTECT(-1)		-0.02 (-1.13)				
COMPETI(-1)			0.00 (0.06)			
COMPETI ² (-1)			0.17 (0.34)			
EMU*COMPETI(-1)			0.51 (0.94)			
CRISIS(-1)				-0.01 (-0.91)	-0.01 (-0.46)	-0.01 (-0.46)
PR. SURPLUS/GDP(-1)				0.00 (0.01)	-0.01 (-0.07)	-0.01 (-0.08)
RIGHT GOV(-1)				-0.01 (-1.45)	-0.01 (-0.99)	-0.01 (-1.00)
CENTER GOV(-1)				0.00 (0.16)	0.00 (0.11)	0.00 (0.12)
ELECTION YEAR(-1)				0.00 (0.51)	0.00 (0.37)	0.00 (0.38)
UNEMPL. BENEF(-1)					-0.13 (-1.58)	-0.13 (-1.53)
EMPL. PROTECT. TRADING PARTNERS(-1)					0.03 (1.46)	0.03 (1.46)
PMKT REGULAT(-1)					-0.01 (-0.47)	0.00 (0.20)
PMKT REGULAT(-2)						0.00 (0.07)
Observations	373	373	355	362	362	362

Notes: Generalized least squares regressions allowing for heteroschedasticity of the error term and including country, sector, and time dummies. *T*-statistics in parentheses. EMPL. PROTECT. TRADING PARTNERS: average of the value of the indicator EMPL. PROTECT. for the trading partners. See notes to tables 2.3, 2.4, and 2.5 and the appendix for the exact definition of all the variables included in the regressions.

***Significant at the 1 percent level.

Alesina et al.: Main findings

- Euro helped product market reforms (3 times larger than ESM) little to no effect on labour market reforms
- Why? Euro increases competition on tradables **sector** and puts pressure upstream.
- Euro ended the Competitive Devaluation: after euro more restructuring in manufacturing sector benefitting from devaluations.
- It may increase price transparency and competition even in non-tradable. More capital flows and contemporaneous changes in technology make markets (energy & communication) more contestable

**What are productivity effects
of these reforms in EU?**

Integration and reforms

- Can integration drive reforms?
- Are there differences? ESM vs euro?
-
- Why are the productivity effects of reforms elusive? Country vs sector differences

One hypothesis

- One hypothesis was that the main reason ESM/Euro effects are elusive is heterogeneity
- Sectoral heterogeneity
- We thought say K-intensive sectors would respond differently to the ESM than labour-int
- We though say the financial sector would respond differently to the euro than real sectors
- We were wrong: country heterogeneity is key

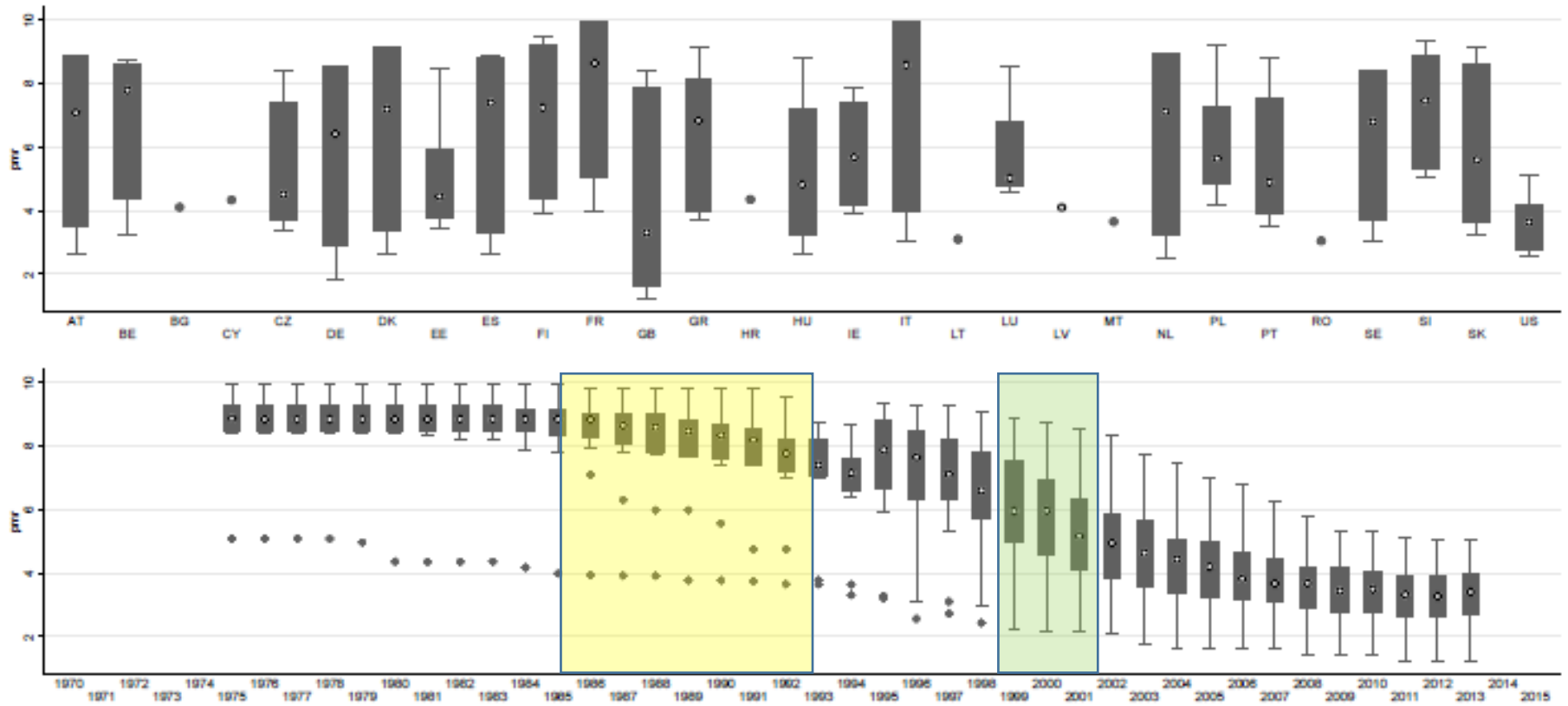
Do ESM/Euro foster structural reforms?

- Yet, happy to be wrong
- R.L.Stevenson “for to travel hopefully is a better thing than to arrive”
- In going for sectoral heterogeneity, we (Campos, Eichenauer & Sturm) feel we made some major progress on the role of ESM/euro on reforms

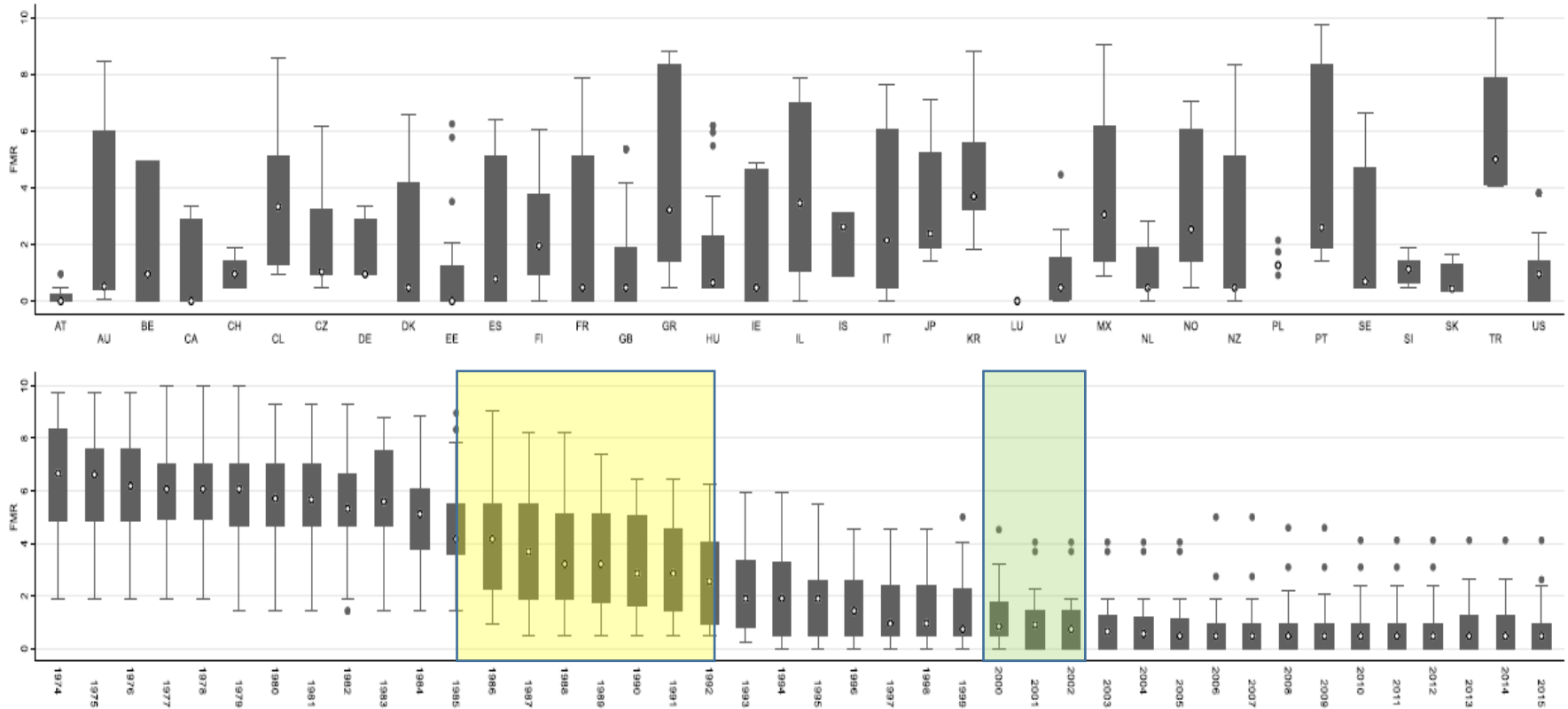
Measurement

- OECD Product market reforms (PMR)
 - Seven sectors: Utilities, transport regulation (ETCR)
 - Interpolation (every 3 years)
 - Three components: entry barriers, public ownership, price controls
- ILO labour market reforms (LMR)
 - Only EPL (excludes eg unemployment benefits)
 - Three components: permanent contracts, temporary contracts, firing/hiring
- OECD Financial market reforms (FMR)
 - Excludes financial globalisation
 - Three components: Credit market controls, entry barriers, supervision
- EUKLEMS for productivity at sectoral level

Product market reform: across countries and over time



Financial market reform: across countries and over time



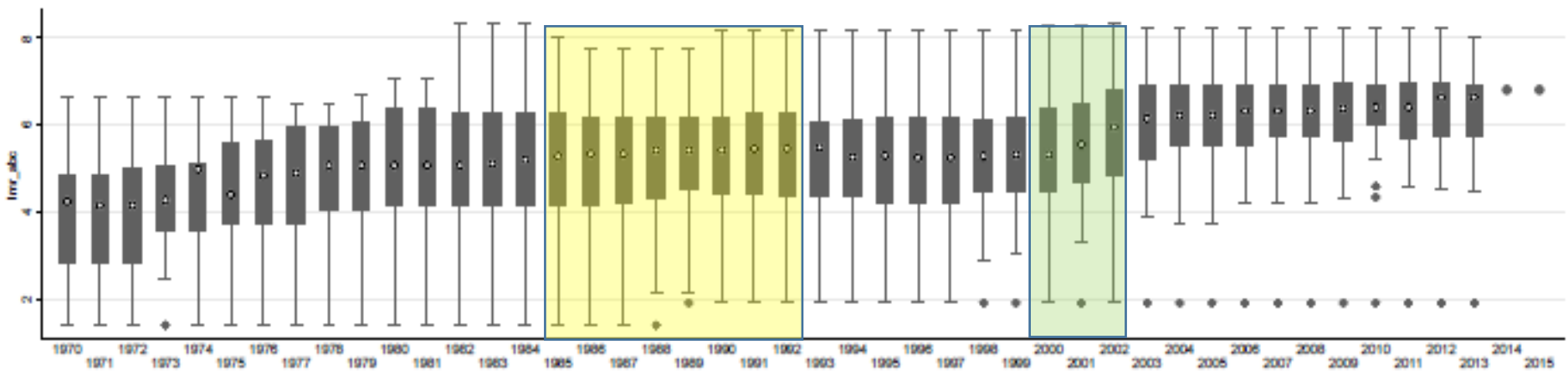
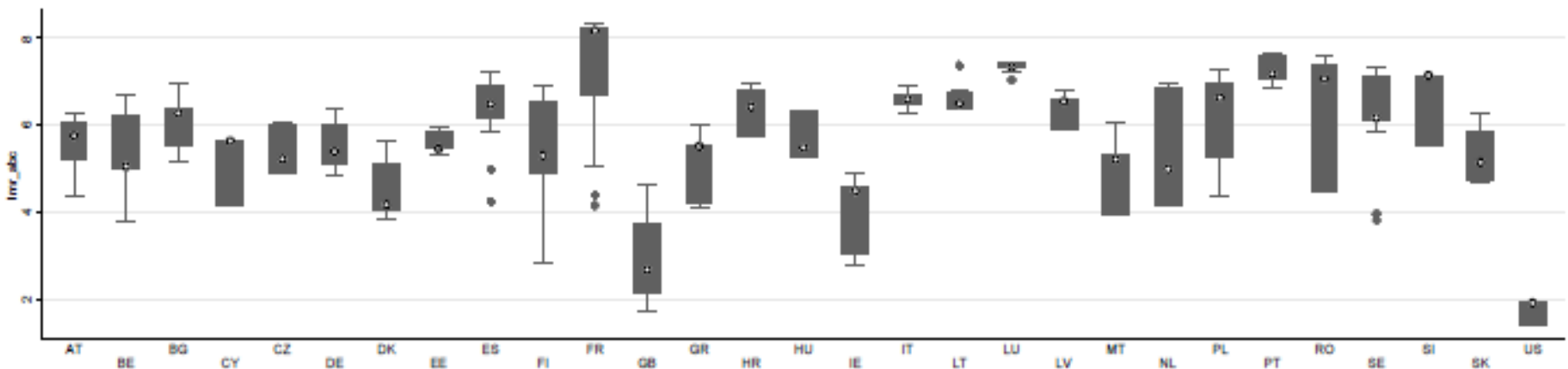
Labour Market Reforms

- «It is interesting to note that the pre-Euro economic debate focused much more on labour market reforms and much less, or not at all, on product markets»

Alesina, Ardagna and Galasso 2011

- Use ILO's CBR indicator because:
 - Conceptually tight (laws and regulations), yet limited (*de jure* not *de facto*)
 - Annual coverage over whole time window: no need to interpolate
 - Meticulously documented, law-by-law
 - 3 levels of possible aggregation: CBR_Overall, 5 areas, CBR_ABC, 40 sub-components
 - 5 areas: (A) regulations about different terms of employment (permanent and part-time work), (B) working time, (C) dismissal laws (firing costs) , (D) employee representation, and (E) collective action.

Labour market reform: across countries and over time



Method: 2-step approach

1. ESM and Euro Structural reforms

- Labour, financial and product market reforms
- Country-level with country- and year-fixed effects
- Decomposition of components relating to structural reforms from OLS

2. Structural reforms Sectoral productivity growth

- OLS regressions with sectoral interactions
- Country-sector level with sector-year- and country-fixed effects

Main findings

- Overall, we find EU integration fosters structural reforms
- Differently from lit, effect of ESM larger than euro's
- Reforms (PMR more than LMR/FMR) increase productivity, *equally* across sectors but *differently* across countries
- PMR: not driven by state control but by barriers to entry
- LMR: not driven by PT but by permanent and hiring/firing
- FMR: not driven by entry barriers but by credit controls

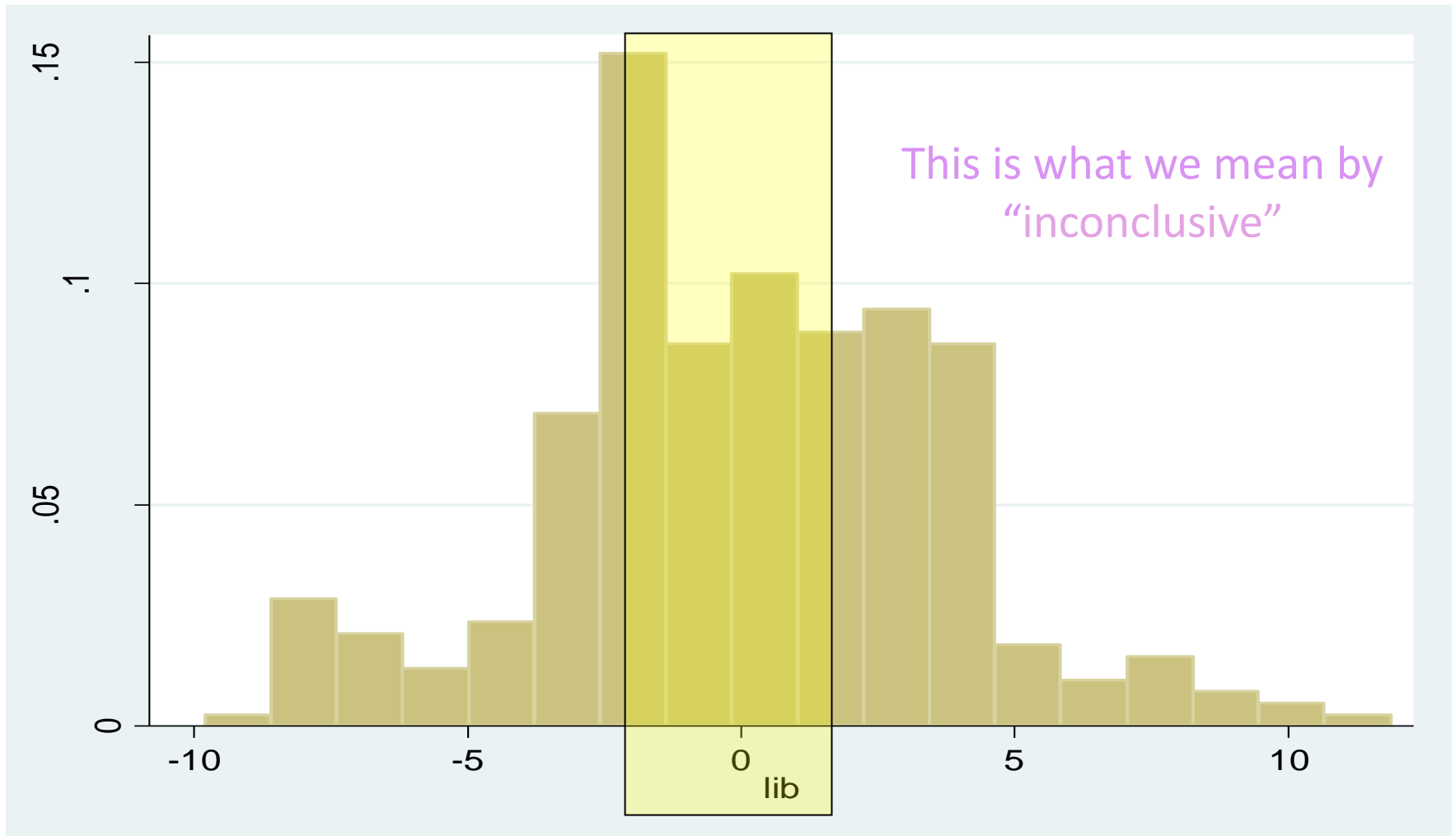
**What do we ought
to do next?**

Identification and measurement

What we ought to

- We have myriad models and evidence
- Identification and Measurement are the bottlenecks now
- Reform measures became popular, gained currency but have not improved enough
- Coordinated, comprehensive, independent

Histogram of the t-statistics of coefficients of structural reforms on economic growth (317 coefficients from the 43 papers)



Source: Campos and Babecky (2005)

Is it worth reforming ... reform measures?

Campos and Horvath, *EJPE* 2012

Took three “key” dimensions: internal liberalization, external liberalization and privatization

Compiled an extensive list of “underlying variables,” annually, for 25 TEs since 1989. Simple and transparent way to normalize and aggregate

Generated “input-only” indicators of reform

Use it to revisit literature that focuses on: Dynamic effects of reform on growth and role of reform reversals

- Reforms do look less impressive but...

Explaining Growth with EBRD (left column) and CH (right) index

(Note that some variables omitted for sake of space)

	Fidrmuc		Falcetti et al.		Merlevede		Kim Pirtilla	
Liberalization	23.3***	26.3***	-13.3	-48.6***	-8.35	-73.2***	-0.86	2.16
Lib. Index -Lagged			10.84***	52.7***	10.79**	75.1***		
Time*IC1			0.27***	0.06	0.78***	0.12		
Time*IC2					0.11	-0.09		
Fiscal	0.073	0.16	0.34***	0.09	0.22**	0.08	0.38***	-0.09
School	0.019	-0.02						
Investment	0.104	0.001**					0.24***	-0.0001
War	-5.97***	-12.7***						
Reversal of reform					25.47*	111.7***		
Growth – lagged							0.37**	0.29***
Cum Lib. Index							9.04***	3.07**
Fiscal - lagged							-0.92	0.55***
Inflation - lagged							0.52	0.01
R2/Chi-squared	0.83	0.28	241***	196***	411***	170***		
Estimation method	FE		3SLS		3SLS		AB	

Explaining Growth with EBF (left column) (right) index

(Note that some variables are written in a smaller space)

	Fin	Ed	Health	Gov	Lib	Open	Trade	Welfare	in Pirtilla
Liberalization	23								0.09
Lib. Index -Lagged									0.16
Time									
Time*IC									
Fiscal									0.09
School									
Investment									0.0001
Revenue									
Growth - lag									0.29***
Cum Lib. Index									9.04***
Fiscal - lag									3.07**
Inflation									-0.92
R2/Chi-squared	0.28	0.33**	0.19	0.28	0.41***	0.17***			0.55***
Estimation method		2SLS			3SLS				AB

Coefficients on reformed reform measures are often LARGER and MORE PRECISELY ESTIMATED than those on the unreformed measures

Reform reversals

- Important because this plays big role in theory
- Privatisation reversals: FDI inflows
- Internal liberalisation reversals: driven by primary form of protest (labour strikes), not by civil war, changes in ideology, democracy or concentration of political power
- External liberalisation reversals: OECD growth (+), TOT (-)

Concluding thoughts

1. Reforms are too important to be left to “reformers” (fanatics) alone
2. Causality (concern) is everywhere but
3. Measurement is key

Děkuji mnohokrát