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Pol Econ of Struc Reform

The Hague
June 3, 2009

Political Economy of Structural Reform

What works, what does not

Coen Teulings

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Financial crisis



Structural Reform

- Financial market liberalization conducive for reform elsewhere
- Hence: financial crisis is a threat
- Same time: crisis creates sense of urgency
- What is the urgency? Mass unemployment!

Persistence and amplification of shocks

	Persistence	Half-life	Amplification
United States	0.44	1.67	0.41
Australia	0.34	1.3	0.24
Germany	0.42	1.6	-0.85
Denmark	0.31	1.2	-0.25
Spain	0.54	2.3	-0.41
France	0.50	2.0	-0.53
Netherlands	0.50	2.0	-0.55
Portugal	0.56	2.4	-0.38
Sweden	0.40	1.5	0.18

What explains cross country differences

	Persistence of shocks	Amplifications of shocks
Replacement rate	0.12	-0.39*
EPL for regular contracts	0.62***	-0.43**
PMR	0.58***	-0.46**
Collective bargaining	0.29	-0.23
Corporatism	-0.52***	-0.54***

Comments

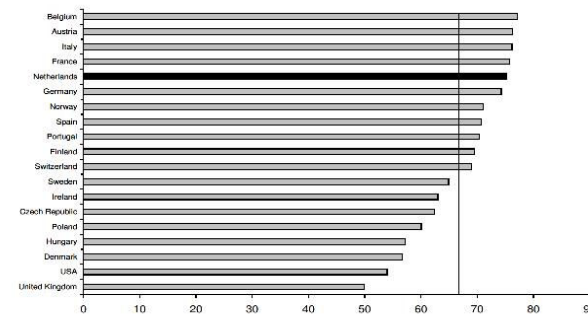
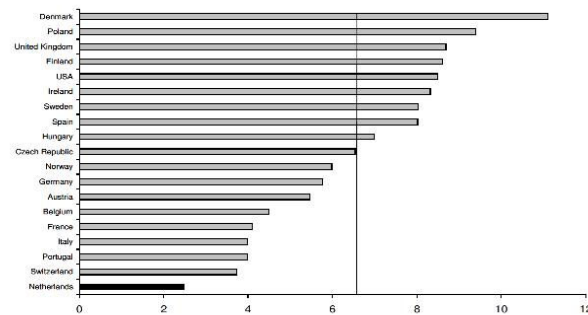
- Utopia in 2 dimensions
 - ▶ Low persistence
 - ▶ Low amplification
- DK = Utopia
 - ▶ High UI, low EPL
 - ▶ Fits *Rhineland Exit* and *Rethinking Retirement*
 - ▶ Fits regression results on UI and EPL
- Experience rating, UI, and EPL
 - ▶ Difference between Experience rating and EPL?
 - ▶ EPL is tenure related
- Missing in analysis
 - ▶ Duration and strictness UI



Job tenure

■ Job tenure males 55-64, < 1 year

■ Job tenure males 55-64 > 10 year



Natural rate of unemployment

Structural unemployment and Policies and Institutions

Replacement rate	0.064***
Labour tax wedge	0.142***
Corporatism	-1.203***
PMR	0.711***
Union density	-0.031
EPL	0.259

Comments

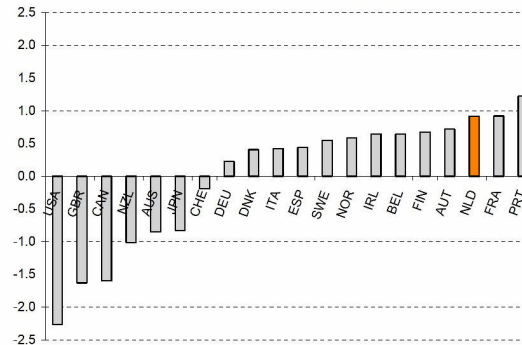
- Determinants natural rate
 - ▶ EPL irrelevant
 - ▶ Corporatism has negative effect

Fits Corporatism or Competition (1998)
- Utopia in 3 dimensions
 - ▶ Low persistence, low amplification
 - ▶ Add: Low natural rate
- Tinbergen's rule: 3 goals → 3 instruments
- Success pro-market reform
 - ▶ Great moderation / Nickell's R&D study
 - ▶ By the way: requires defense after this crisis
 - ▶ Hence: merge all variables in one indicator

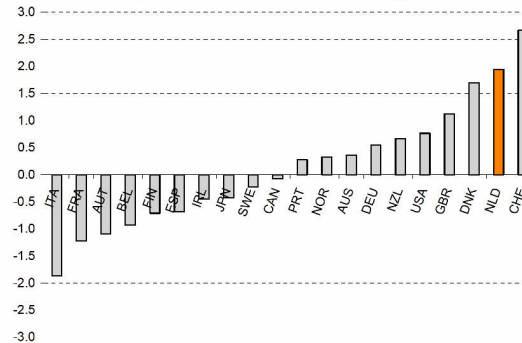
Market indicator and mortgages

ECO/WKP(2007)27

Figure 2.1. Cross-country comparison of the value of explanatory variables
Synthetic indicator of labour and product market regulation, 2003
(number of standard deviations around the 2003 OECD average)



Household mortgage debt
(number of standard deviations around the 2002 OECD average)



Source: Authors' estimates. See main text for details.

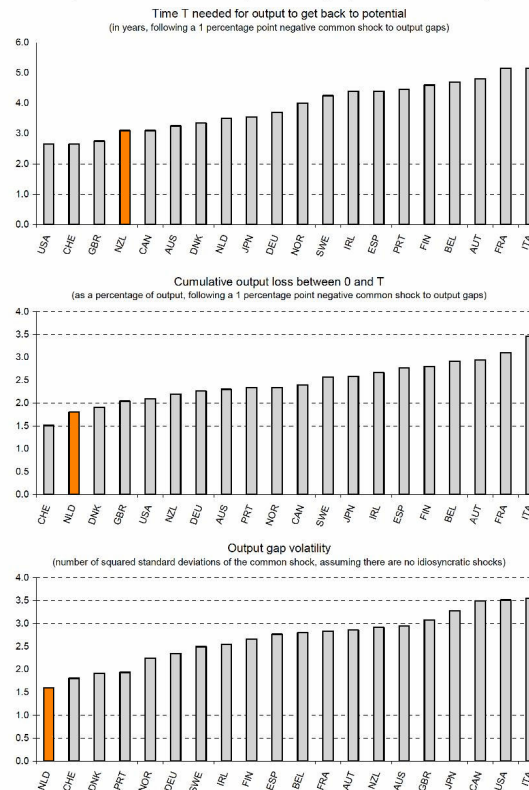
Comments

- Importance of mortgage debt: hard to believe
 - ▶ NL thinks of our mortgage debt as a problem
 - ▶ Due to fiscal treatment, not depth of financial market
 - ▶ Yields excess leverage
 - ▶ Reduce mortgage debt, do not increase it!
- What is needed?
 - ▶ Persistence is the main problem, hence:
 - ▶ Reform along DK-lines
 - ▶ Maintaining UI (maybe better experience rated)
 - ▶ Reduction EPL
 - ▶ Timing is crucial: do it during the recovery!

Welfare evaluation

ECO/WKP(2007)27

Figure 2.3. Simulated degrees of resilience according to three alternative criteria
(based on Table 2.4, Column 5, using 2003 values of policy and institutional indicators)



Source: Authors' estimates. See main text for details.

Comments

- US is not necessarily Utopia
- Quadratic loss function?
 - ▶ Amplification more costly than Persistence
- Aggregate demand externality?
 - ▶ Loss function: $L = \text{Sum}(u - u_{\text{natural rate}} + u_{\text{externality}})^2$
 - ▶ or: adjustment for long term unemployment

Political Economy

- Main obstacle to reform:
transfer between generations
- Example 1: fiscal treatment mortgages
 - ▶ Raises house prices
 - ▶ = n.p.v. future tax benefits
 - ▶ Current generation captures benefits all future deductions
- Example 2: EPL
 - ▶ Hold up problem
 - ▶ Current benefits at expense future job creation
- Hence: reforms may lead to higher public debt
 - ▶ Offsetting transfer between generations
- Explains why reform is hard during consolidation