Weighing up the Growth Dividends from Structural Reforms

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In many OECD countries, economic growth has yet to recover the lost ground suffered in the aftermath of the financial crisis. In some of them, unemployment has been persistently high, investment rates disappoint, and productivity is extremely sluggish – a "low growth trap". Put differently, all three sources of sustainable long-run growth under-perform. This jeopardizes societies' ability "to make good on its promises to current and future generations – to create jobs and develop career paths for young people, to pay for health and pension commitments to old people". (OECD, 2016). While this partly reflects the persistent weakness of demand in some cases (Mann, 2016), there are policy tools available that affect the long-run productive capacity of the economy, or potential growth. Our recent work takes a fresh view on the relative payoffs in terms of raising future growth (Égert and Gal, 2016). We study how various product and labour market policies and regulations affect per capita income growth over different horizons and through the three supply-side channels: multi-factor productivity (MFP), capital deepening and employment.

We find that product market regulation (PMR) reforms have the largest overall direct policy impact: reducing regulatory barriers to competition induce a cumulative increase of 0.7% of GDP per capita over a 5-year horizon. Other policies with considerable overall effects include increased spending on active labour market policies (ALMPs), a reduction in labour tax wedge, in the minimum wage or in the length of maternity leave with impacts ranging from 0.3% to 0.5%. Typical reforms in other policy areas tend to have a smaller impact on per

capita income (Figure 1).

Figure 1. The impact of reforms on GDP per capita 5 and 10 years after the reforms
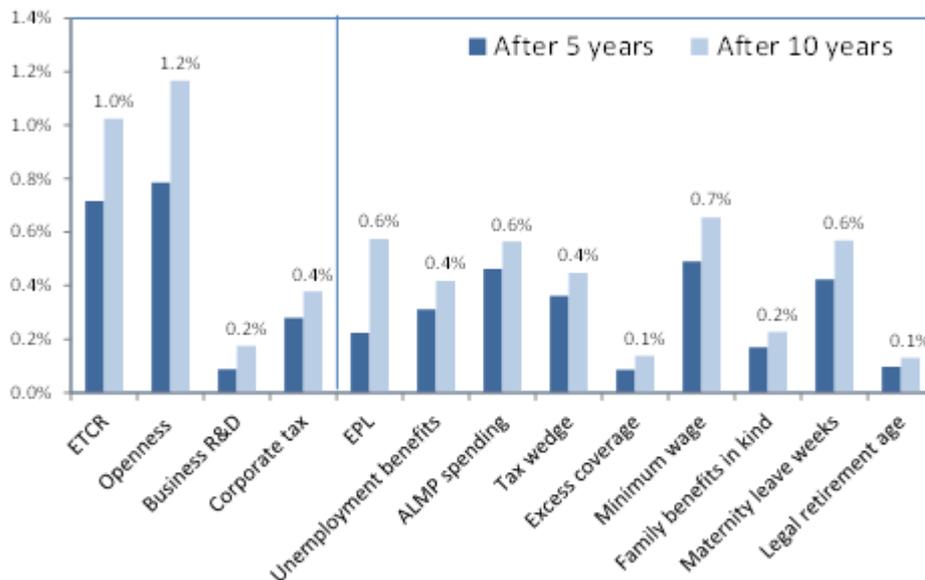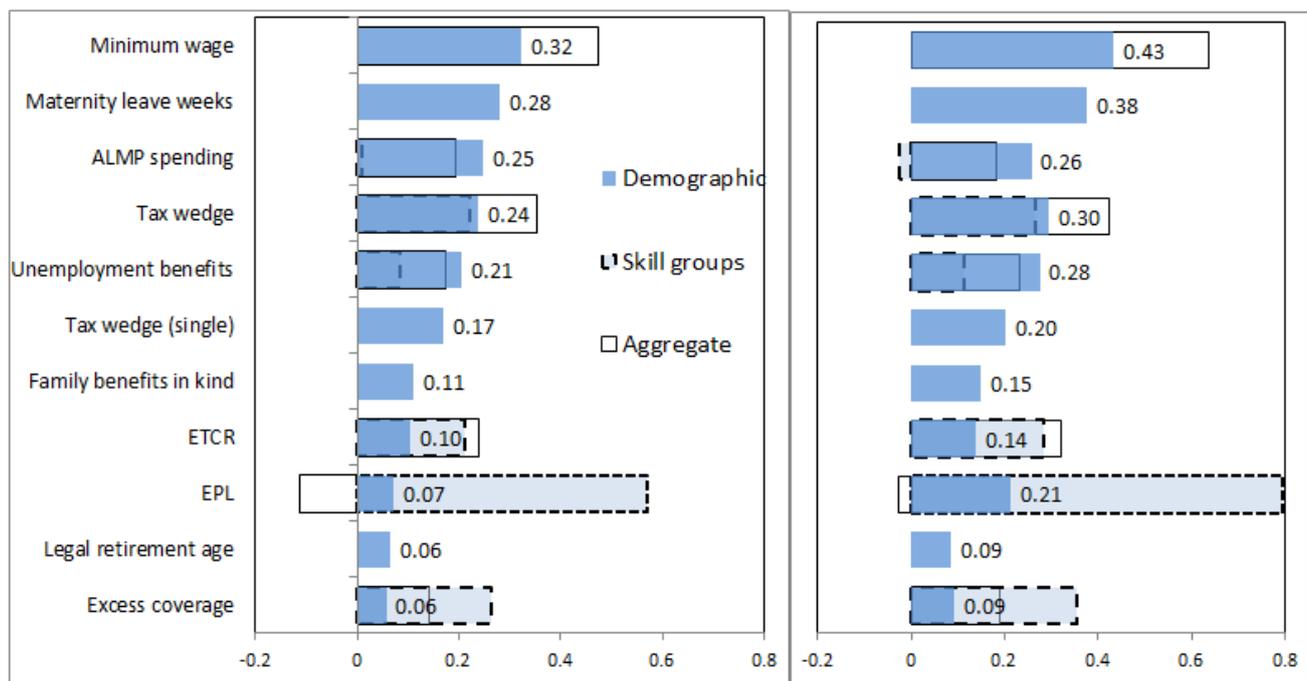

Note: Typically observed reforms are measured here by the average of all beneficial two-year policy changes that were observed over two consecutive years in the sample.

Different policies have different impacts on the separate supply-side components. For instance, PMR affects each of them, while labour market policies tend to impact only employment. Exceptions are ALMPs, which affects both productivity and employment, and EPL, which drives both capital deepening and employment. Finally, the corporate tax has an effect only on capital deepening, while R&D impacts only productivity (Figure 2).

The policy effects differ over longer horizons. For instance, the overall long-term effects on GDP per capita of PMR, employment protection (EPL) and ALMP spending are considerably larger than the 5-year impacts. This is mainly due the fact that MFP and capital are slower to react to reforms, compared to employment (Figure 1).

These results are based on past policy changes and assume that the impacts are uniform across countries and various institutional settings. But the estimation results shown in Figures 1 and 2 could be used as a starting point to provide

precious help for policy makers for the elaboration of comprehensive structural reform packages. Depending on the ease with which reforms can be implemented, policies could be picked to reach policy objectives in terms of overall impact on per capita income. A natural follow-up to our paper would be to extend it to take into account country specificities and differences in the initial policy and institutional settings. Also, the enriched framework could be used to build an interactive policy simulator, which would help policy-makers to figure out the impact of planned reforms and to design comprehensive policy packages to achieve objectives such as a given increase in per capita income over a given horizon.

Figure 2: Effects of improving structural policies
Predicted effects of typically observed reforms* in each policy area

Productivity

Policy	5 years	10 years
Openness	0.8%	1.2%
ETCR	0.5%	0.7%
ALMP	0.1%	0.2%
R&D	0.1%	0.2%

Physical capital

Policy	5 years	10 years
Corporate tax	0.6%	0.8%
EPL	0.2%	0.5%
ETCR	0.07%	0.15%

Employment
(in percentage points)

After 5 years   *After 10 years*

Note: *Typically observed reforms are measured as the average improvements in the policy indicators over all two year windows that show improvements in both periods (see Table 5, column 4). The employment rate effects use all three aggregation approaches, and the size of the effects is indicated by numbers for the aggregation using demographic groups. See details in Egert and Gal (2016)

Source: Égert, B. and P. Gal (2016), "The quantification of structural reforms in OECD countries: a new framework", OECD Economics Department Working Papers, No. 1354, OECD Publishing, Paris.

References

Égert, B. and P. Gal (2016), "The quantification of structural reforms in OECD countries: a new framework", OECD Economics Department Working Papers, No. 1354, OECD Publishing, Paris.

Mann, C. L. (2016), "Deploy effective fiscal initiatives and promote inclusive trade policies to escape from the low-growth trap" ECOSCOPE, November 28.

OECD (2016), "Economic Outlook", Vol 2016(1).