

STRUCTURAL REFORM AND GREECE: LESSONS FROM OTHER LANDS

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Athens, October 2015

Outline

- Deconstructing “structural reform”
 - empirics and theory
 - Illusions of knowledge, universality, large growth benefits
- Yet growth-enhancing reforms do exist, and they are not necessarily difficult
 - they just require a different approach and mind set

International evidence on structural reform

- Rich body of experience from Latin America, former socialist economies, and Asia
- Rarely brought to bear on discussion of reform issues in Europe

The mixed evidence on structural reform

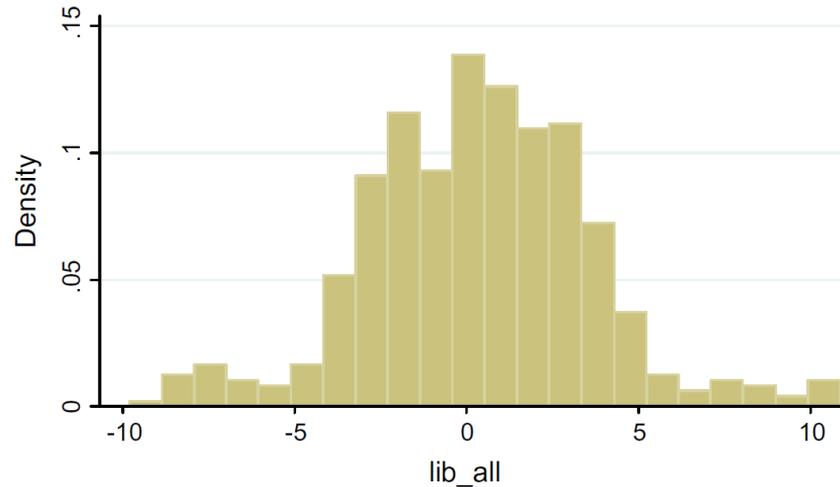


Fig. 1. Histogram of the t -statistics of coefficients of structural reforms on economic growth: 515 coefficients from the 46 papers listed in Appendix A (excludes five outliers: coefficients whose t -statistics exceed three standard deviations).

Somewhat better in the long run...

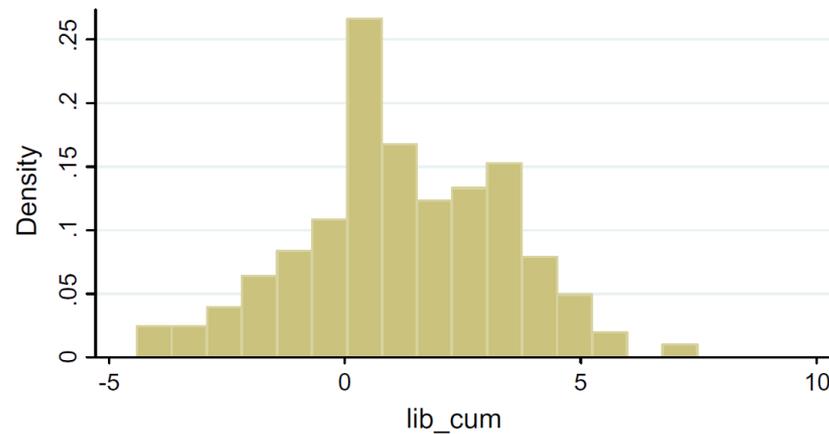


Fig. 3. Histogram of the t -statistics of coefficients of cumulative effect of structural reforms on economic growth: 276 coefficients from papers listed in Appendix A (excludes six outliers: coefficients whose t -statistics exceed three standard deviations).

... than in the short run

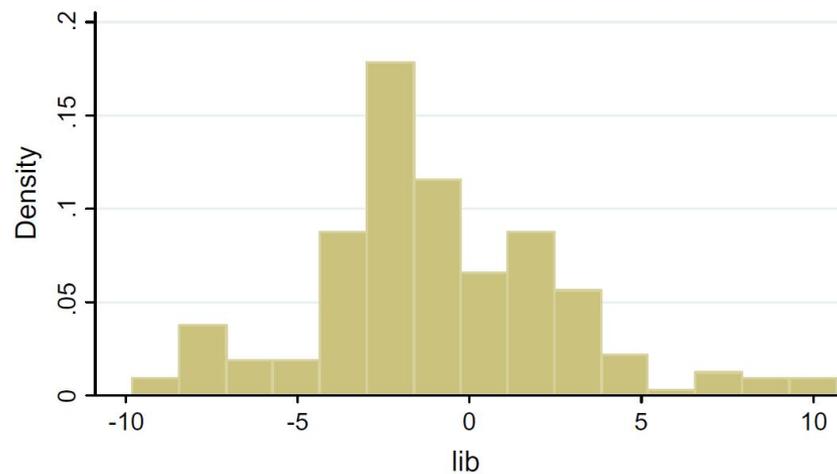
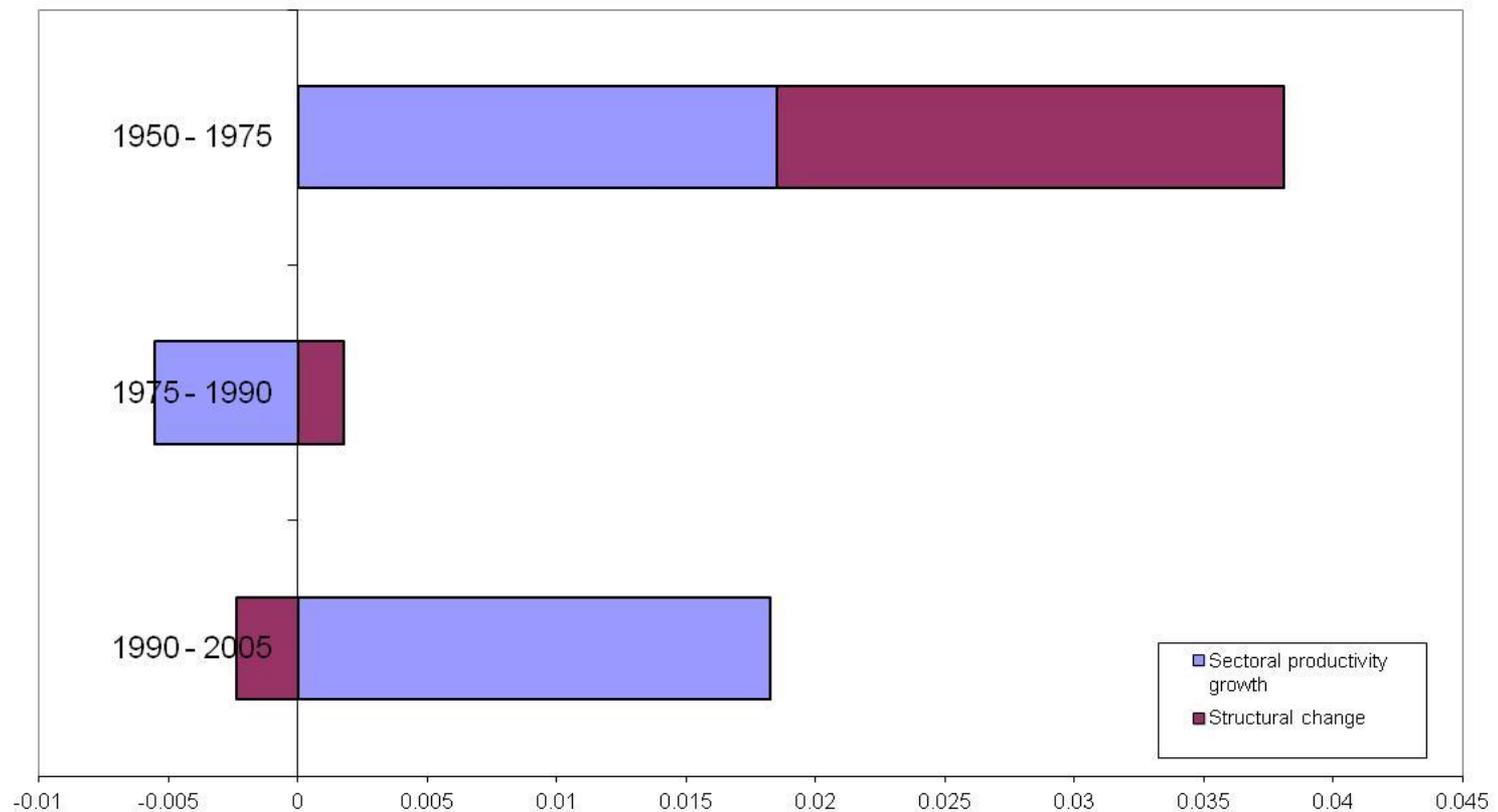


Fig. 2. Histogram of the t -statistics of coefficients of contemporaneous structural reforms on economic growth: 234 coefficients from papers listed in Appendix A (excludes four outliers: coefficients whose t -statistics exceed three standard deviations).

Source: Babecký and Campos (2010)

Latin American experience with structural reforms

Productivity decomposition in Latin America across different periods
(annual growth rates)



Source: McMillan and Rodrik (2011)

What is “structural reform”: theory

- Improvements in regulation and institutions to enhance efficiency with which markets operate
 - reducing transaction costs of market activity
 - product and service markets: licensing fees and other costs
 - labor markets: hiring/firing costs
 - reducing entry barriers
 - eliminating monopolies
 - enhancing role of private sector over government
 - improved public sector administration
 - e.g., tax collection, rule of law
- Raises potential income of the economy
 - how do deregulation, improved tax collection, or ending corruption in public procurement raise growth?

What is “structural reform”: empirics

- Convergence equation

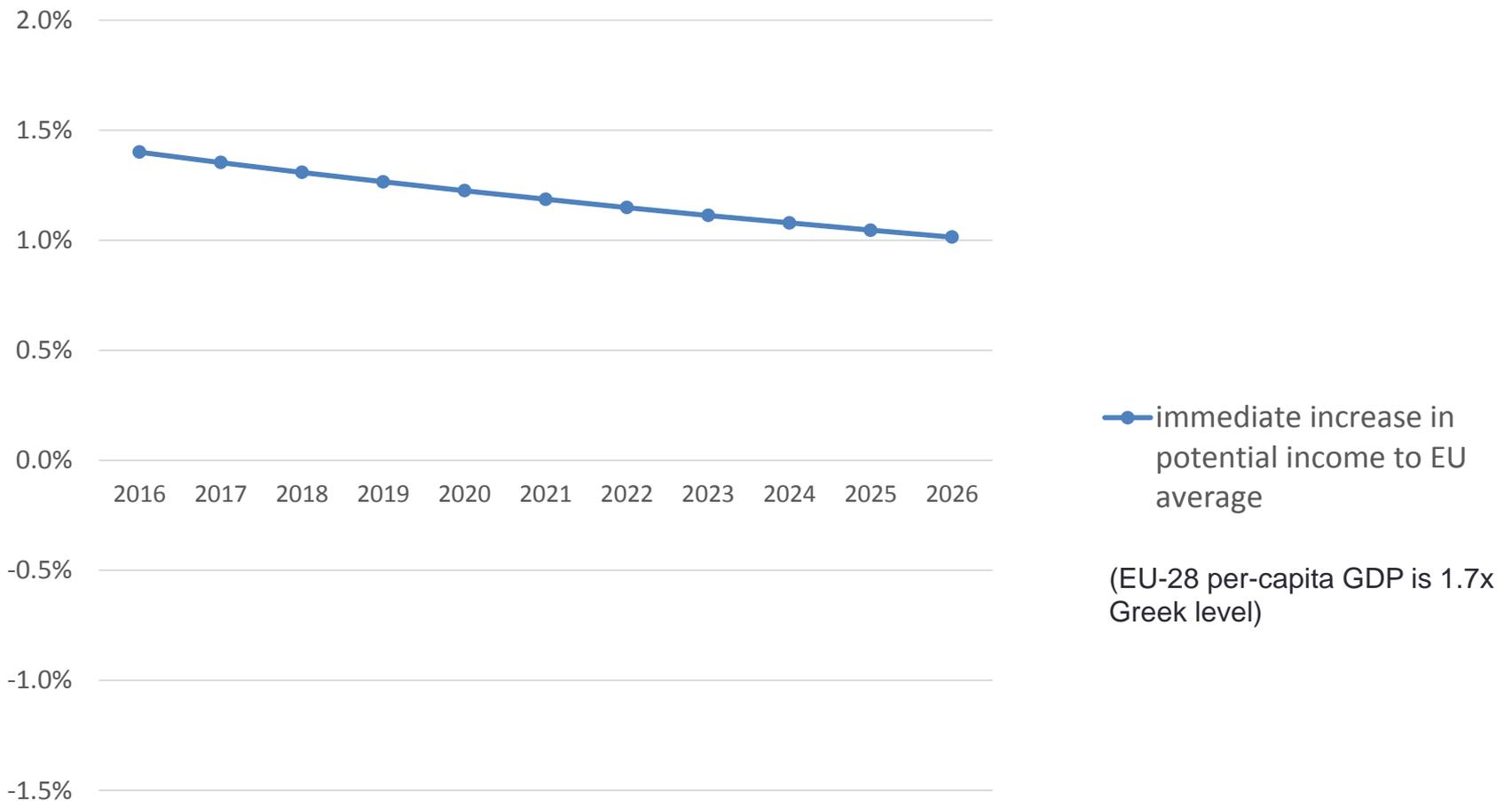
$$g_t = \beta \left(\frac{y_t^*}{y_t} - 1 \right) + \epsilon_t$$

rate of convergence
($\beta \approx 2\%$)

difference between
potential and actual income

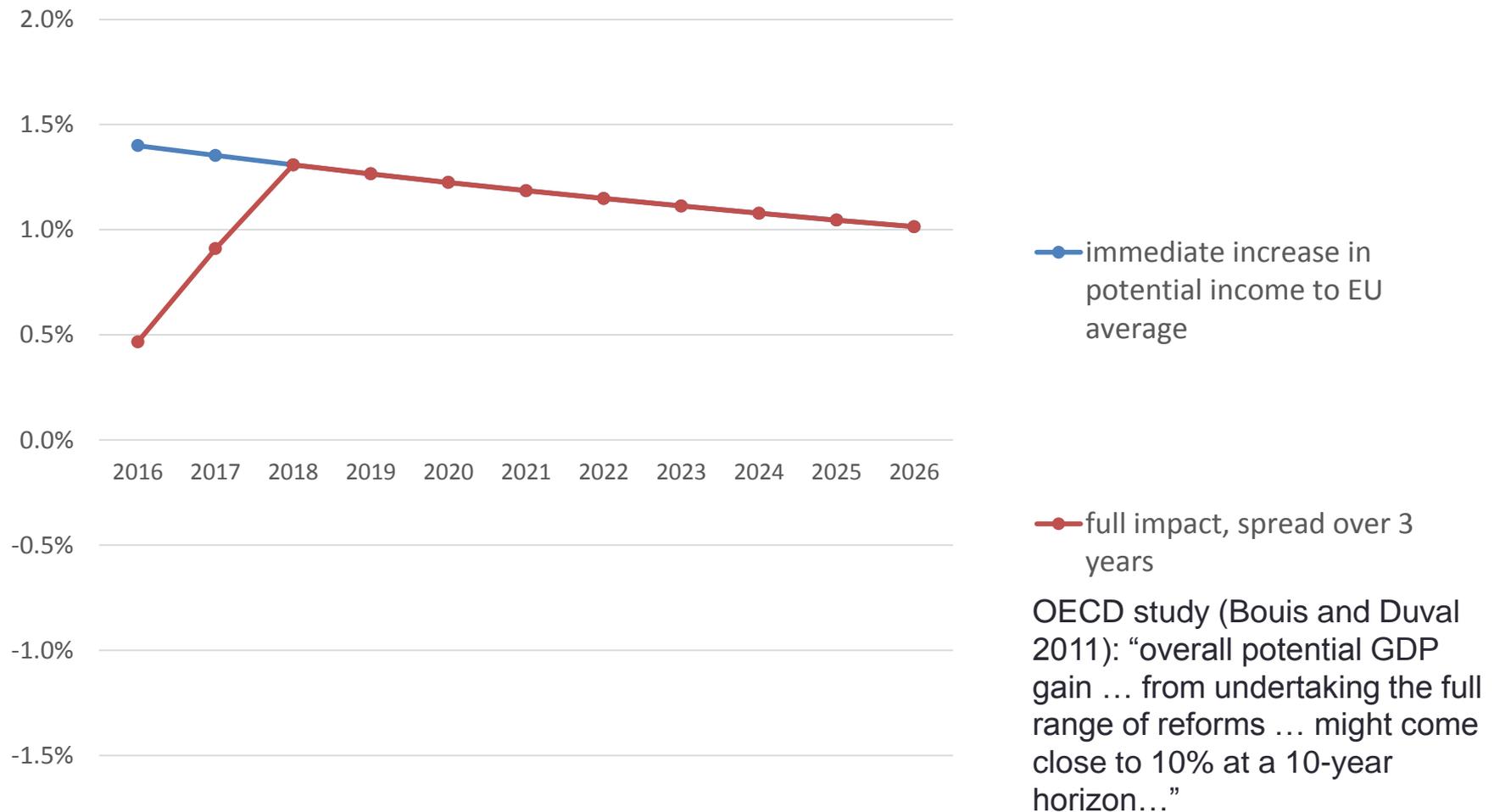
Some quantitative illustrations

Growth impetus from structural reform



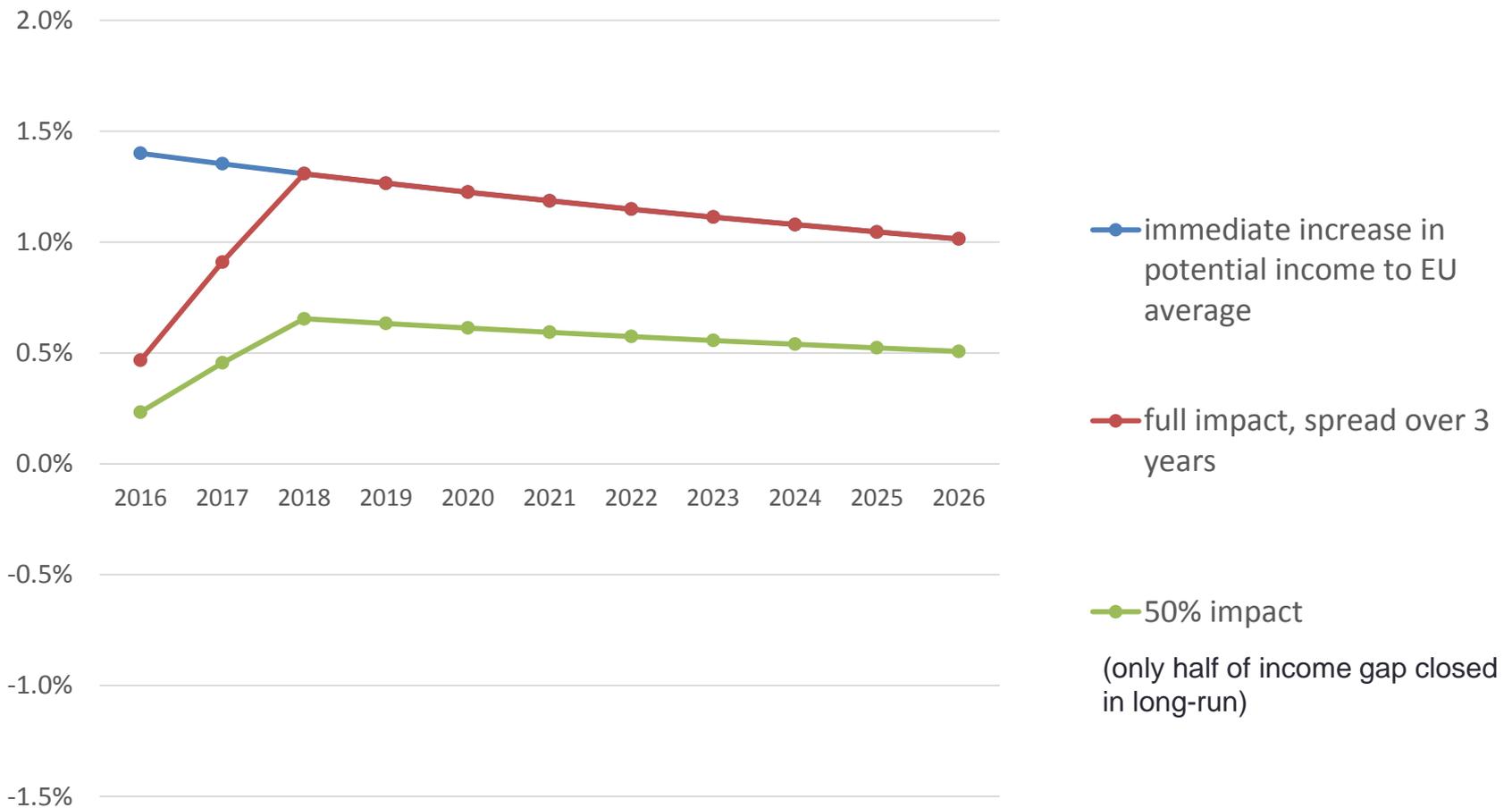
Some quantitative illustrations

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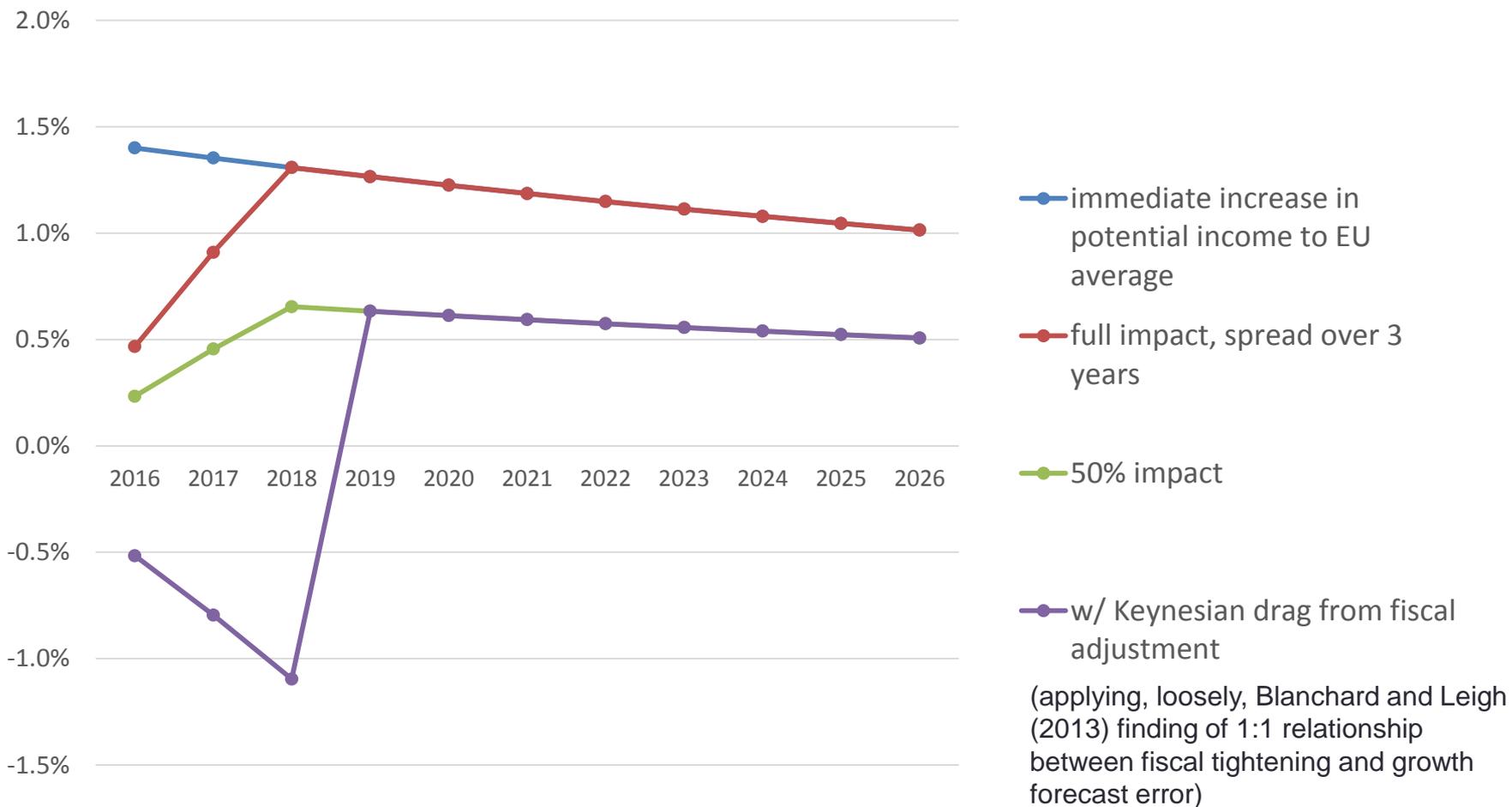
Some quantitative illustrations

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Some quantitative illustrations

Growth impetus from structural reform



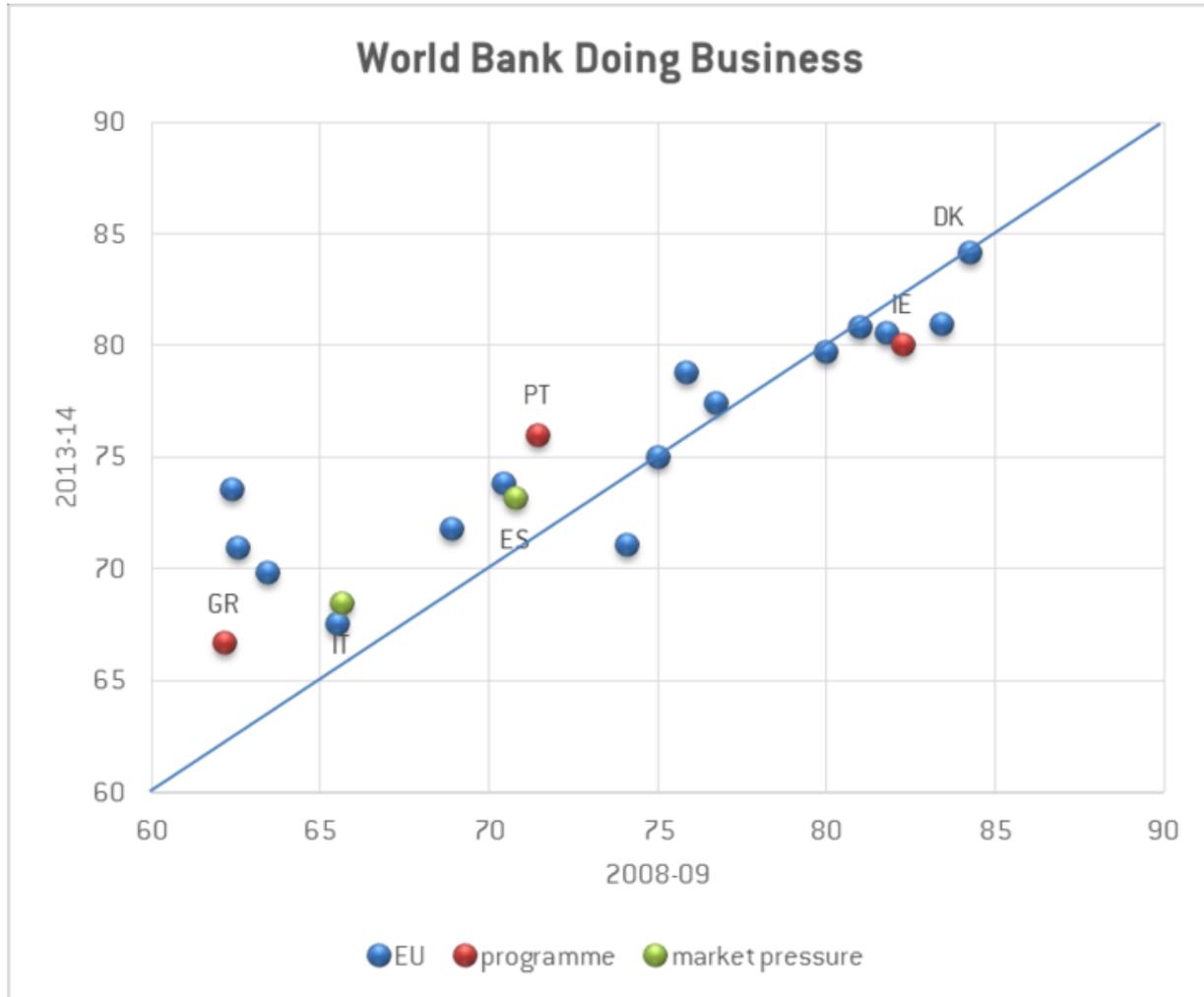
Implementation?

Figure 1: Heat map business environment

	Year		Greece	Italy	Portugal	Spain
	Before the crisis	Recent				
DB Dealing with construction permits	2008	2013	↗	↘	↗	↘
DB Enforcing contracts	2008	2013	↘	↗	↗	↗
DB Getting credit	2008	2013	↗	→	→	→
DB Paying taxes	2008	2013	↗	↗	↗	↗
DB Protecting investors	2008	2013	↗	→	→	→
DB Resolving insolvency	2008	2013	↘	↗	↗	↗
DB Starting a business	2008	2013	↗	↗	↗	↗
DB Trading across borders	2008	2013	↗	↗	↗	↗
FI Business regulation	2008	2011	↘	↗	↗	↗
WB Regulatory quality	2008	2012	↘	↘	↘	↘
WEF Goods markets	2008	2013	↘	↘	↘	↘
IJ Business late payments	2008	2013	↘	↘	↗	↘
IJ Public late payments	2008	2013	↘	↘	↗	↘
FI Legal structure and property rights	2008	2011	↘	↗	↘	↗
WB Rule of law	2008	2012	↘	↘	↗	↘
CEPEJ Clearance rate	2008	2012*	↘	↗	↗	↗
CEPEJ Disposition time	2008	2012*	↘	↘	↗	↘
PMR State control	2008	2013	↗	↗	↗	↗
PMR Barriers to trade and investment	2008	2013	↗	↗	→	↗
PMR Barriers to entrepreneurship	2008	2013	↗	↗	↗	↗

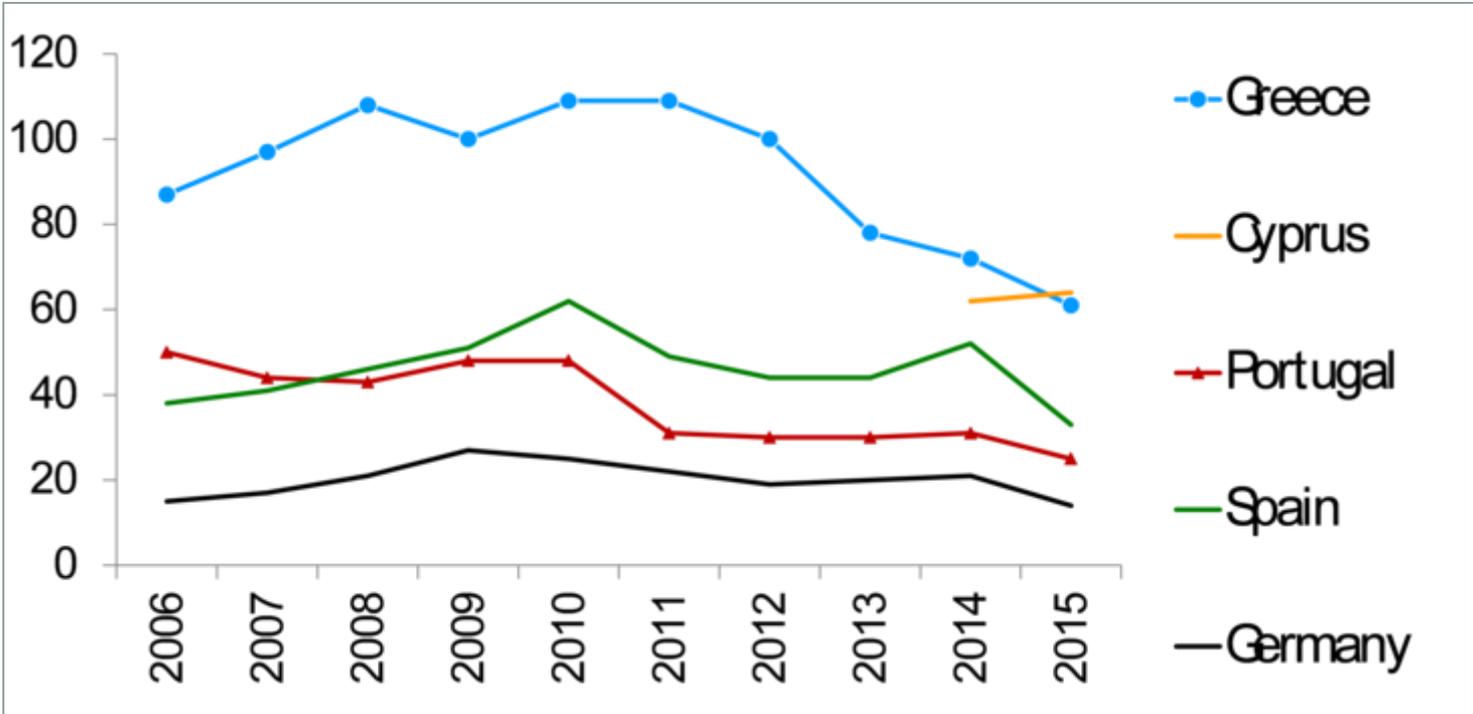
*Spain information refers to 2010

Notes: CEPEJ clearance rate and disposition time are computed for total non-criminal cases. Sources: World Bank and International Finance Corporation Doing Business, World Bank Worldwide Governance Indicators, OECD, Fraser Institute, World Economic Forum, Intrum Justitia, CEPEJ.



Source: Terzi (2015)

World Bank ease of doing business ranking, 2006-2015



Source: Darvas (2015)

Implementation

- “The country with the largest improvement in the overall PMR [product market regulation] score is Greece (-0.54), followed by Poland (-0.34), Portugal (-0.40) and the Slovak Republic (-0.26). While Greece is still among the OECD countries with relatively strict product market regulations, it has made a substantial leap forward.”

OECD (2014)

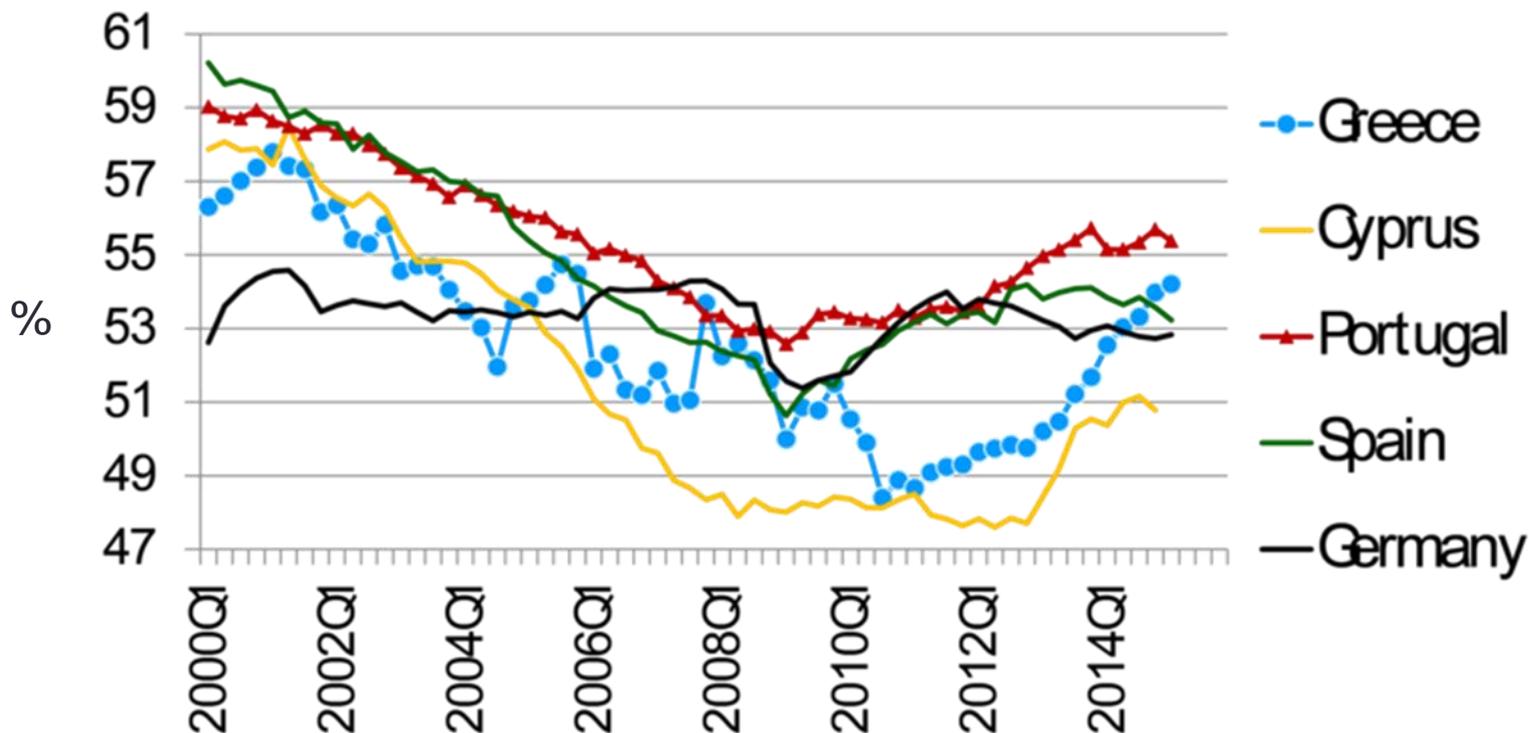
A puzzle...

- Yet significant growth accelerations do happen
- In HPR (2005), we identified 87 episodes during 1957-1992
 - $\Delta g > 2\%$ and $g > 3.5\%$ over at least 8 years
- They are frequent
 - likelihood that a country will experience one in any given decade is 25%
- And not well predicted by standard economic determinants
 - e.g., liberalization
 - fewer than 15% of liberalizations produce growth accelerations, and only 16% of growth accelerations are preceded by economic liberalization
- Why do some reforms produce much more immediate and larger impacts?
 - Hint: it's not about the ambition or magnitude of reforms

Rule #1: target binding constraints

- Being far from the frontier means well-chosen reforms have very large payoffs
- Advantages to
 - fighting political battles where they really matter
 - focusing scarce administrative resources on high-return areas
- In Greece, fundamental short-term problem is unemployed resources (people!)
 - traditional demand management tools (fiscal, monetary) unavailable
 - so big return to policies that enhance competitiveness of traded sector
 - simultaneously relieve internal and external problems
 - many others won't produce as big a bang
 - deregulating taxis, notaries, pharmacies, shopping hours...
- Policy tools?
 - sectoral tax/credit/input price incentives, regulation-light zones, FDI incentives, targeted infrastructure investment, deliberation forums,...
 - low export and diversification levels are not destiny
 - comparative evidence suggest robust response to credible changes in incentive regime (KOR, TWN, TUR,...)

Share of tradables in private sector GDP



Tradables have done better than non-tradables since 2010, but only because they have not collapsed as much...

Rule #2: beware second-best interactions

- A. Dixit: “the world is second-best, at best.”
- The theory of second best, in a nutshell:
 - what is good in ideal world may be bad in real world
 - alternatively, what’s merely desirable may be hyper good
- Examples
 - fiscal revenue-competitiveness tradeoffs
 - labor-cost gains in exportables undone by increases in energy prices (excise taxes plus state enterprise price hikes) (Pelagidis 2014)
 - deregulation-unemployment tradeoffs
 - efficiency gains in deregulated/privatized industries come from shedding excess labor; this is not desirable when unemployment is 25%
 - making it easier to fire labor has little effect on hiring when firms have excess capacity and cannot sell their output
 - consequence is both higher unemployment and lower productivity gains

- Why attempted comprehensive reform in Latin America underperformed:
 - “In the aggregate, the reforms did not have a significant direct impact on the growth rate, because the different individual components of the reform package have offsetting effects.” (Morley 2000)
- Avoiding such interactions is added reason for targeting binding (rather than all) constraints
 - Chinese sequence: agriculture, industry, trade, finance...

Rule #3: avoid “isomorphic mimicry”*

- Functions that good institutions perform
 - appropriate incentives, macroeconomic stability, social welfare
- Do not map into unique forms
 - Example: variety of export promotion institutions around the world
 - export subsidies (KOR, TUR), tax incentives (TWN), SEZs (CHN), EPZs (MUS), import liberalization (CHL), DFI promotion (MYS),... →
- “Best practice” is illusion
- Institutional flexibility enables designs that overcome complementarity among standard reforms
 - Chinese examples: two-track price reform, SEZs
 - transformed very demanding reforms into manageable ones
- Need for local creativity, imagination in institutional design →

* Pritchett, Woolcock, Andrews (2010)

Multiplicity of institutional arrangements

OBJECTIVE	UNIVERSAL PRINCIPLES	PLAUSIBLE DIVERSITY IN INSTITUTIONAL ARRANGEMENTS
<p><u>Productive efficiency</u> (static and dynamic)</p>	<p><u>Property rights</u>: Ensure potential and current investors can retain the returns to their investments</p> <p><u>Incentives</u>: Align producer incentives with social costs and benefits.</p> <p><u>Rule of law</u>: Provide a transparent, stable and predictable set of rules.</p>	<p>What type of property rights? Private, public, cooperative?</p> <p>What type of legal regime? Common law? Civil law? Adopt or innovate?</p> <p>What is the right balance between decentralized market competition and public intervention?</p> <p>Which types of financial institutions/corporate governance are most appropriate for mobilizing domestic savings?</p> <p>Is there a role for “industrial policy” to stimulate investment in non-traditional areas?</p>

OBJECTIVE

Macroeconomic and
Financial Stability

UNIVERSAL PRINCIPLES

Sound money: Do not generate liquidity beyond the increase in nominal money demand at reasonable inflation.

Fiscal sustainability: Ensure public debt remains “reasonable” and stable in relation to national aggregates.

Prudential regulation: Prevent financial system from taking excessive risk.

PLAUSIBLE DIVERSITY IN INSTITUTIONAL ARRANGEMENTS

How independent should the central bank be?

What is the appropriate exchange-rate regime? (dollarization, currency board, adjustable peg, controlled float, pure float)

Should fiscal policy be rule-bound, and if so what are the appropriate rules?

Size of the public economy.

What is the appropriate regulatory apparatus for the financial system?

What is the appropriate regulatory treatment of capital account transactions?

OBJECTIVE

Distributive justice and poverty alleviation

UNIVERSAL PRINCIPLES

Targeting: Redistributive programs should be targeted as closely as possible to the intended beneficiaries.

Incentive compatibility: Redistributive programs should minimize incentive distortions.

PLAUSIBLE DIVERSITY IN INSTITUTIONAL ARRANGEMENTS

How progressive should the tax system be?

Should pension systems be public or private?

Should grant schemes be conditional?

What are the appropriate points of intervention: educational system? access to health? access to credit? labor markets? tax system?

What is the role of “social funds”?

Redistribution of endowments? (land reform, endowments-at-birth)

Organization of labor markets: decentralized or institutionalized?

Modes of service delivery: NGOs, participatory arrangements., etc.



A sea change in growth strategies globally... except in Europe?

- From presumptive strategies...
 - with long laundry list of reforms
 - focusing on complementarity of reforms rather than prioritization or sequencing
 - with a bias towards universal recipes and “best-practices”
- To diagnostic strategies
 - agnostic ex ante on what works and what doesn't
 - search for context-specific binding constraints
 - some experimentation central part of discovery
 - focus on sequence of selective, more narrowly targeted reforms
 - suspicious of “best-practice,” universal remedies
 - looking for policy innovations that unlock local second-best/political complications

Final words: political economy

- Two styles of reform
 1. Big bang: exploiting “window of opportunity”
 - costs upfront, modest and delayed benefits
 - works when political anchors in place: Poland and EU
 - threat of backlash otherwise: Bolivia, Venezuela
 2. Sequential targeting of binding constraints: building political support over time
 - rapid growth when successful
 - quintessential Asian model: China, etc.
 - tends to preserve rents of insiders
 - but requires ongoing reform effort over longer term
 - threat of getting stuck midway