

REUNIÃO DE CONJUNTURA

23/10/2017

Artigos de Bancos Centrais e BIS

Ben Bernanke: Temporary price-level targeting: An alternative framework for monetary policy	1
Vítor Constâncio: Growth in a more resilient Euro area	7
Mario Draghi: Structural reforms in the euro area	14



Ben Bernanke: Temporary price-level targeting: An alternative framework for monetary policy

Text by Mr Ben Bernanke, former Chairman of the Board of Governors of the Federal Reserve System, published on his blog, 12 October 2017

* * *

Low nominal interest rates, low inflation, and slow economic growth pose challenges to central bankers. In particular, with estimates of the long-run equilibrium level of the real interest rate quite low, the next recession may occur at a time when the Fed has little room to cut short-term rates. As I have written previously and recent research has explored, problems associated with the zero-lower bound (ZLB) on interest rates could be severe and enduring. While the Fed has other useful policies in its toolkit such as quantitative easing and forward guidance, I am not confident that the current monetary toolbox would prove sufficient to address a sharp downturn. I am therefore sympathetic to the view of San Francisco Fed President John Williams and others that we should be thinking now about adjusting the framework in which monetary policy is conducted, to provide more policy “space” in the future. In a paper presented at the Peterson Institute for International Economics, I propose an option for an alternative monetary framework that I call a temporary price-level target—temporary, because it would apply only at times when short-term interest rates are at or very near zero.

To explain my proposal, I’ll begin by briefly discussing two other ideas for changing the monetary framework: raising the Fed’s inflation target above the current 2 percent level, and instituting a price-level target that would operate at all times. (See my paper for more details.)

A HIGHER INFLATION TARGET

One way to increase the scope for monetary policy is to retain the Fed’s current focus on hitting a targeted value of inflation, but to raise the target to, say, 3 or 4 percent. If credible, this change should lead to a corresponding increase in the average level of nominal interest rates, which in turn would give the Fed more space to cut rates in a downturn. This approach has the advantage of being straightforward, relatively easy to communicate and explain; and it would allow the Fed to stay within its established, inflation-targeting framework. However, the approach also has a number of notable shortcomings (as I have discussed here and here).

One obvious problem is that a permanent increase in inflation would be highly unpopular with the public. The unpopularity of inflation may be due to reasons that economists find unpersuasive, such as the tendency of people to focus on inflation’s effects on the prices of things they buy but not on the things they sell, including their own labor. But there are also real (if hard to quantify) problems associated with higher inflation, such as the greater difficulty of long-term economic planning or of interpreting price signals in markets. In any case, it’s not a coincidence that the promotion of price stability is a key part of the mandate

of the Fed and most other central banks. A higher inflation target would therefore invite a political backlash, perhaps even a legal challenge.

More subtle, but equally important, we know from the insightful theoretical work of Paul Krugman, Michael Woodford and Gaudi Eggertsson, and others that raising the inflation target is an inefficient approach to dealing with the ZLB. Under the theoretically optimal approach, inflation should rise temporarily following a severe downturn in which monetary policy is constrained by the ZLB. The reason for the temporary increase is that, in the optimal framework, policymakers promise to hold rates “lower for longer” when the ZLB is binding, in order to make up for the fact that the ZLB is preventing current short-term rates from falling as far as would be ideal. The promise of “lower for longer,” if credible, should ease financial conditions before and during the ZLB period, reducing the adverse effects on output and employment but subsequently resulting in a temporary increase in inflation. As Woodford has pointed out (pp. 64-73), raising the inflation target is a suboptimal response to the ZLB problem in that it forces society to bear the costs of higher inflation at all times, instead of only transitorily after periods at the ZLB. Moreover, a once-and-for-all increase in the inflation target does not take into account that, under the theoretically optimal policy, the vigor of the policy response (and thus the magnitude of the temporary increase in inflation) should be calibrated to the duration of the ZLB episode and the severity of the economic downturn.

PRICE-LEVEL TARGETING

An alternative monetary framework, discussed favorably by President Williams and by a number of others (see here and here) is price-level targeting. A price-level-targeting central bank tries to keep the level of prices on a steady growth path, rising by (say) 2 percent per year; in other words, a price-level-targeter tries to keep the very-long-run average inflation rate at 2 percent.

The principal difference between price-level targeting and conventional inflation targeting is the treatment of “bygones.” An inflation-targeter can “look through” a temporary change in the inflation rate so long as inflation returns to target after a time. By ignoring past misses of the target, an inflation targeter lets “bygones be bygones.” A price-level targeter, by contrast, commits to reversing temporary deviations of inflation from target, by following a temporary surge in inflation with a period of inflation below target; and an episode of low inflation with a period of inflation above target. Both inflation targeters and price-level targeters can be “flexible,” in that they can take output and employment considerations into account in determining the speed at which they return to the inflation or price-level target. Throughout this post I am considering only “flexible” variants of policy frameworks. These variants are both closer to the optimal strategies derived in economic models and most consistent with the Fed’s dual mandate, which instructs it to pursue maximum employment as well as price stability.

A price-level target has at least two advantages over raising the inflation target. The first is that price-level targeting is consistent with low average inflation (say, 2 percent) over time and thus with the price stability mandate. The second advantage is that price-level targeting has the desirable “lower for longer” or “make-up” feature of the theoretically optimal monetary policy. Under price-level targeting, there is automatic compensation by policymakers for periods in which the ZLB prevents monetary policy from providing adequate stimulus. Specifically, periods in which inflation is below target (as is likely to happen when interest rates are stuck at the ZLB) must be followed by periods in which the central bank shoots for inflation above target, with the overshoot depending (as it optimally should) on the severity of the episode and the cumulative shortfall in monetary easing. If the public understands and expects the central bank to follow the “lower-for-longer” rate-setting strategy, then the expectation of easier policy and more-rapid growth in the future should mitigate declines in output and inflation during the period in which the ZLB is binding, and indeed reduce the frequency with which the ZLB binds at all.

For these reasons, adopting a price-level target seems preferable to raising the inflation target. However, this strategy is not without its own drawbacks. For one, it would amount to a significant change in the Fed’s policy framework and reaction function, and it is hard to judge how difficult it would be to get the public and markets to understand the new approach. In particular, switching from the inflation concept to the price-level concept might require considerable education and explanation by policymakers. Another drawback is that the “by-gones are not by-gones” aspect of this approach is a two-edged sword. Under price-level targeting, the central bank cannot “look through” supply shocks that temporarily drive up inflation, but must commit to tightening to reverse the effects of the shock on the price level. [1] Given that such a process could be painful and have adverse effects on employment and output, the Fed’s commitment to this policy might not be fully credible.

TEMPORARY PRICE-LEVEL TARGETING

Is there a compromise approach? One possibility is to apply a price-level target and the associated “lower-for-longer” principle only to periods around ZLB episodes, retaining the inflation-targeting framework and the current 2 percent target at other times. As with the ordinary price-level target, this approach would implement the lower-for-longer or “make-up” strategy at the ZLB, which—if understood and anticipated by the public—should serve to make encounters with the ZLB shorter, less severe, and less frequent. In this respect, a temporary price-level target would be similar to an ordinary price-level target, which applies at all times. However, a temporary price-level target has two potential advantages.

First, a temporary price-level target would not require a major shift away from the existing policy framework: When interest rates are away from the ZLB, the current inflation-targeting framework would remain in place. And at the ZLB, what I am calling here temporary price-level targeting could be explained and communicated as part of an overall inflation-targeting strategy, as it amounts to targeting the average inflation rate over the period in which the ZLB is binding. Thus, communication could remain entirely in terms of inflation goals, a concept with which the public and market participants are already familiar.

Second, a temporary price-level target, unlike an ordinary price-level target, would not require the Fed to tighten policy to reverse shocks that temporarily drive up inflation when rates are away from the ZLB. Instead, following the inflation-targeter's approach, the Fed would simply guide inflation back to target over time. Moreover, because the Fed would be targeting 2 percent inflation in both ZLB and non-ZLB periods, inflation over long periods should average around 2 percent.

To be more concrete on how the temporary price-level target would be communicated, suppose that, at some moment when the economy is away from the ZLB, the Fed were to make an announcement something like the following:

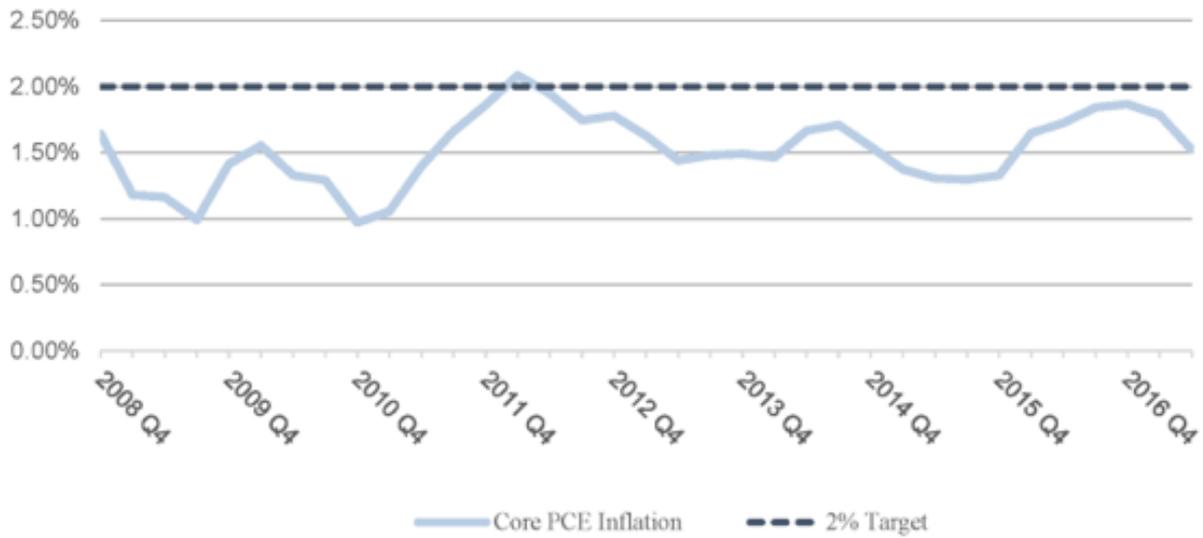
The Federal Open Market Committee (FOMC) has determined that it will retain its symmetric inflation target of 2 percent. The FOMC will also continue to pursue its balanced approach to price stability and maximum employment. In particular, the speed at which the FOMC aims to return inflation to target will depend on the state of the labor market and the outlook for the economy.

However, the FOMC recognizes that, at times, the zero lower bound on the federal funds rate may prevent it from reaching its inflation and employment goals, even with the use of unconventional monetary tools. The Committee therefore agrees that, in future situations in which the funds rate is at or near zero, a necessary condition for raising the funds rate will be that average inflation since the date at which the federal funds rate first hit zero be at least 2 percent. Beyond this necessary condition, in deciding whether to raise the funds rate from zero, the Committee will consider the outlook for the labor market and whether the return of inflation to target appears sustainable.

The charts below serve to illustrate this policy as might have been applied to the most recent ZLB episode if, hypothetically, temporary price-level targeting had been in effect. To be clear, nothing in this blog post or my paper should be taken as a commentary on current Fed policy. I am considering instead a counterfactual world in which the announcement above had been made, and internalized by markets, prior to when the short-term rate hit zero in 2008.

Figure 1 shows the behavior of (core PCE) inflation since 2008 Q4, the quarter in which the federal funds rate effectively reached zero and thus marked the beginning of the ZLB episode. Since 2008, inflation has been below the 2 percent inflation target most of the time.

Figure 1: Inflation Since 2008 Q4 (Annual Rates)

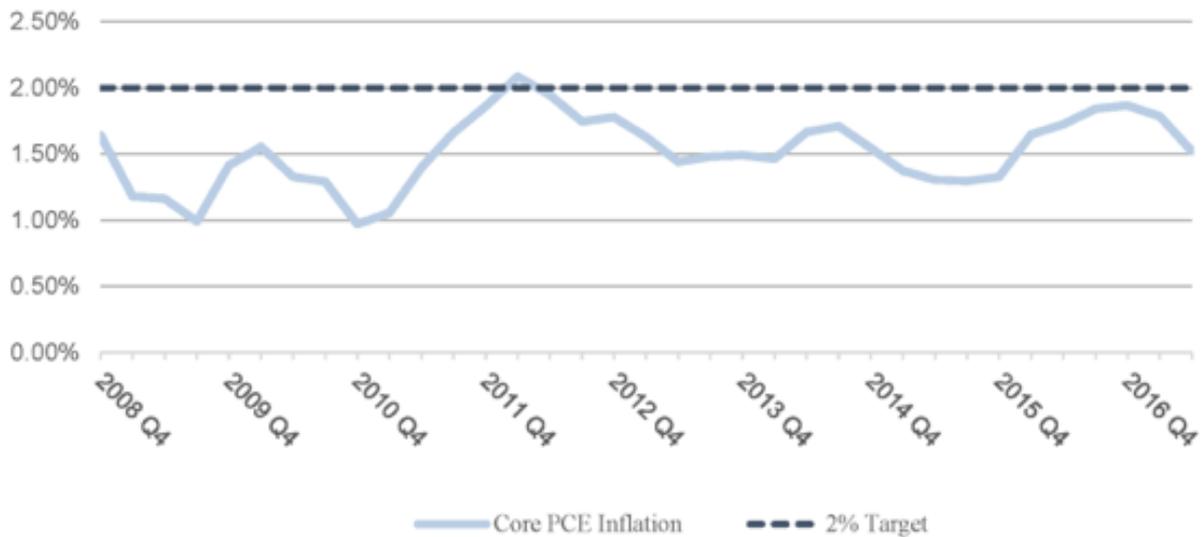


Source: FRED.



The effect of this persistent undershoot of inflation relative to the 2 percent target has been a persistent undershoot of the overall level of prices, relative to trend. Figure 2 shows recent values of the (core PCE) price level relative to a 2 percent trend starting in 2008 Q4. As the figure shows, the price level is lower than it would have been had inflation been at the Fed's 2% inflation target over the entire period.

Figure 1: Inflation Since 2008 Q4 (Annual Rates)



Source: FRED.



If a temporary price-level target had been in place, the Fed would have sought to “make up” for this cumulative shortfall in inflation. The necessary condition outlined in paragraph (2) of the framework, that average inflation over the ZLB period be at least 2 percent, is equivalent to the price level (light blue line) returning to its trend (dark blue line). A period of inflation exceeding 2 percent would be necessary to satisfy that criterion, thereby compensating for the previous shortfall in inflation during the ZLB period (i.e. the slope of the light blue line would need to increase in order to converge with the dark blue line). The result would be a lower-for-longer rates policy, which would be communicated and internalized by markets in advance. The easier financial conditions that would have resulted could have hastened the desired outcomes of economic recovery and the return of inflation to target. Notably, this framework would obviate the need for (and be superior to) the use of ad hoc forward guidance about rate policy.

Importantly, under my proposal and as suggested by the mock FOMC statement above, meeting the average-inflation criterion is a necessary but not sufficient condition to raise rates from the ZLB. First, monetary policymakers would want to be sure that the average inflation condition is being met on a sustainable basis and not as the result of a transitory shock or measurement error. Expressing the condition in terms of core rather than headline inflation, as in the figures above, would help on that score. Second, consistent with the concept of “flexible” targeting, policymakers would also want to factor in real economic conditions such as employment and output in deciding whether it was time to raise rates.

In sum, a temporary price-level target, invoked only during ZLB episodes, appears to have many of the benefits of ordinary price-level targeting. It would preserve the commitment to price stability. Importantly, it would create the expectation among market participants that ZLB episodes will lead to “lower-for-longer” or “make-up” rate policies, which would ease financial conditions and help mitigate the frequency and severity of such episodes. Unlike an ordinary price-level target, however, the temporary variant could be folded into existing inflation-targeting regimes in a straightforward way, minimizing the need to change longstanding policy frameworks and communications practices. In particular, central bank communication could remain focused on inflation goals. Finally, in contrast to an ordinary price-level target, the proposed approach would allow policymakers to continue to “look through” temporary inflation shocks that occur when rates are away from the ZLB.

[1] This problem would be mitigated but not eliminated if the price-level target were defined in terms of core inflation, excluding volatile food and energy prices.

Fonte: Brookings

<https://www.brookings.edu/blog/ben-bernanke/2017/10/12/temporary-price-level-targeting-an-alternative-framework-for-monetary-policy/>

Vítor Constâncio: Growth in a more resilient Euro area

Remarks by Mr Vítor Constâncio, Vice-President of the European Central Bank, on a panel entitled "The Global Economy: Prospects for Broad-Based Growth", at the 32nd Annual G30 International Banking Seminar, Washington DC, 15 October 2017

* * *

Ladies and Gentlemen,

It is a great pleasure to be part of such a distinguished panel. In my remarks today, I would like to reflect on the euro area's recent economic developments and prospects. In doing so, I will outline the role monetary policy has played – and will continue to play – in supporting the recovery, while also touching upon some of the additional policies required to firmly secure a self-sustained recovery.

The main message I would like to convey is that the euro area economy is experiencing a broad-based, robust and resilient recovery, which is underpinned by the monetary policy measures introduced by the ECB since June 2014. Despite this favourable growth dynamics, inflation developments have been subdued. We remain confident that the continued closing of the output gap will lead inflation to return to our medium-term objective, yet this return remains conditional on a very substantial degree of monetary accommodation.

Looking beyond monetary policy, considerable reforms have been implemented and institutional progress has been achieved since the crisis, but supply-side policies are still required at the national level to boost potential growth, while at the euro area level, further institutional reforms are needed to enhance the functioning of EMU.

Recent economic developments and prospects

In the second quarter of 2017, euro area real GDP expanded for the 17th consecutive quarter, growing by 2.3% year-on-year and exceeding our expectations from earlier in the year. Growth is also becoming more broad-based across euro area countries, showing the lowest dispersion since the beginning of the monetary union. The flow of survey data in the third quarter has been encouraging and bodes well for continued growth momentum in the period ahead.

Robust economic activity is also being translated into a substantial amount of job creation. Almost 7 million more people are now employed in the euro area than in mid-2013, which implies that all of the employment losses recorded during the crisis have been offset. The improving labour market combined with increasing household wealth, strong consumer confidence and favourable financing conditions should all support continued robust private consumption. Investment prospects also look promising, which reflects both the need to make up for forgone investment in previous years as well as the highly accommodative

financing conditions which have been passed through to lower borrowing costs for euro area firms.

The resilience of the recovery reflects the strength of domestic demand which in turn, is being supported by the very favourable financing conditions stemming from the monetary policy measures introduced since June 2014 (see Chart 1).

ECB staff counterfactual simulations indicate that absent our measures, GDP-weighted euro area 10-year government bond yields would, at present, be about 154 basis points higher and lending rates to NFCs about 68 basis points higher. ECB staff estimates indicate that our measures are contributing to an increase in euro area GDP of around 1.7%, cumulatively over the period 2016–2019 (see Chart 2) – well above monetary policy’s contribution to the two previous euro area recoveries in 2003Q2-2006Q4 and 2009Q3-2011Q3.

Looking ahead, the latest ECB staff projections continue to expect domestic demand to remain the key driver of euro area growth. Annual real GDP is projected to increase by 2.2% in 2017, 1.8% in 2018 and 1.7% in 2019. The risks to the growth outlook are broadly balanced. According to the latest IMF WEO projections, euro area real GDP is expected to grow by 2.1% in 2017 before moderating to 1.9% in 2018 and 1.7% in 2019, which is in line with the ECB projections.

There are reasons to believe that the strengthening of economic activity, which so far has been significantly supported by accommodative monetary policy, will progressively be supported by more structural factors. Euro area governments have undertaken substantial policy actions and reforms to redress pre-crisis related macroeconomic imbalances and increase economic resilience. [3] For instance, euro area countries which had previously experienced large current account deficits are now in surplus. Moreover, both ECB staff and IMF estimates indicate that the largest driver of this adjustment is non-cyclical in nature, which implies a higher likelihood of sustainability as the recovery continues. Additionally, business cycle synchronisation across euro area countries has increased in recent years. [4] Finally, most countries that had large budget deficits have now positive primary surpluses. In sum, the euro area is now in a better state to withstand future economic or financial shocks.

Despite robust growth dynamics, inflation developments have been subdued. Euro area headline inflation stood at 1.5% in September 2017, according to Eurostat’s flash estimate and is expected to temporarily decline towards the turn of the year owing to energy-related base-effects. Measures of underlying inflation have not yet showed convincing signs of a sustained upward trend (see Chart 3).

Looking further ahead and according to the latest ECB staff projections, inflation is expected to rise to 1.5% in 2017, 1.2% in 2018 and 1.5% in 2019. There are uncertainties clouding the medium-term outlook for price stability, most notably the recent exchange rate volatility, which requires monitoring with regard to possible implications for inflation dynamics. The inflation outlook from the recent IMF WEO depicts inflation at 1.5% in 2017 and 1.4% in 2018, which is broadly in line with ECB projections.

The apparent disconnect between strong economic activity, on the one hand, and low inflation and wages on the other, is one of the stand-out characteristics of the ongoing recovery.⁶ From a policymaker's perspective, a predictable relationship between slack and inflation represents a key monetary policy transmission mechanism through which central banks exert their effect on inflation dynamics.

While there is no agreed upon approach to estimating a Phillips curve linking inflation to slack, on the whole empirical estimates indicate that the slope is currently flatter than in the period preceding the crisis, with several explanations as to why this might be the case. One reason relates to the choice of slack measurement, as the crisis may have led to structural changes in the labour market. For example, when a broader measurement of unemployment is used (Unemployment 6, currently just below 18%) as opposed to the narrower definition (Unemployment 3, standing at 9.1%), the slope of the euro area Phillips curve appears to have become steeper in recent years. Other reasons proposed include: external factors including globalisation, the enhanced role of adaptive expectations in influencing wage and price decisions, anchored by central bank targets, and finally, non-linearities and time-varying behaviour of different Phillips curve coefficients. [7]

Overall, a steepening Phillips curve provides confidence that the continued closing of the output gap will gradually lead inflation to return to our medium-term objective. Yet, this return remains conditional on a very substantial degree of monetary accommodation.

It is against this background that the Governing Council will decide over the autumn period on a re-calibration of its instruments, with a view to safeguarding the monetary policy impulse that is still necessary to secure a sustained adjustment in the path of inflation, in a way that is consistent with our monetary policy aim.

Other policies

Notwithstanding the strength of the ongoing recovery, supply-side policies as well as institutional reforms are required in order to firmly secure a self-sustainable recovery and a better functioning euro area. Country level policies should be aimed at increasing productivity and facilitating innovation and business investment. Turning to Europe and European reforms, the most relevant ones concern the completion of Banking Union, meaningful progress in the Capital Markets Union and the creation of an additional budgetary stabilisation function for the euro area. Both the Five Presidents Report on "Completing Europe's Economic and Monetary Union" (2015) and the recent EU Commission paper on the "Deepening of the Economic and Monetary Union" (2017), provide sufficient guidance on the way to proceed towards a stronger monetary union.

[1] Notes: The impact of credit easing is estimated on the basis of an event-study methodology which focuses on the announcement effects of the June-September package; see the EB article "The transmission of the ECB's recent non-standard monetary policy measures" (Issue 7 / 2015). The impact of the DFR cut rests on the announcement effects of

the September 2014 DFR cut. APP encompasses the effects of January 2015, December 2015, March 2016, and December 2016 measures. The January 2015 APP impact is estimated on the basis of two event-studies exercises by considering a broad set of events that, starting from September 2014, have affected market expectations about the programme; see Altavilla, Carboni, and Motto (2015) “Asset purchase programmes and financial markets: lessons from the euro area” ECB WP No 1864, and De Santis (2015), “Impact of the asset purchase programme on euro area government bond yields using market news”, ECB WP No. 1939. The quantification of the impact of the December 2015 policy package on asset prices rests on a broad-based assessment comprising event studies and model-based counterfactual exercises. The impact of the March 2016 measures and the impact of the December 2016 measures are assessed via model-based counterfactual exercises. Lending rates refer to rates to NFCs. *Changes in lending rates are based on monthly data, the reference period for which is May 2014 to August 2017. Latest observation: 4 October 2017.

[2] Notes: HICP inflation and real GDP growth are based on the September 2017 MPE; the median and range reflect estimates of HICP inflation and real GDP growth over the projection horizon in the absence of monetary policy support; these estimates are obtained from three different exercises: BMEs, the SAPI Task Force and the Expert Group. Latest observation: 2017 Q2 for real GDP and 2017 Q3 for HICP.

[3] See remarks by V. Constâncio, “Growth, adjustment and resilience in the euro area” at the Forum Villa d’Este, Cernobbio, 1 September 2017.

[4] Bayoumi, T. and B. Eichengreen (2017), “Aftershocks of monetary unification: Hysteresis with a Financial Twist”, IMF Working Paper No. 17/55.

[5] Notes: The dynamic factor model (U2 Core) is based on the full 93 HICP items from each of 12 countries. Super-core is based only on those items in HICP excluding food and energy that are sensitive to slack as measured by the output gap. The range includes exclusion-based measures, trimmed means and a weighted median. Latest observation: August 2017 and September 2017 for HICP excluding food and energy. Latest observation: August 2017 and September 2017 for HICP excluding food and energy.

[6] For more details see remarks by V. Constâncio, “Understanding and overcoming low inflation” at the ECB Conference on “Understanding inflation: lessons from the past, lessons for the future?”, Frankfurt am Main, 21 and 22 September 2017

[7] *ibid* , for a detailed discussion

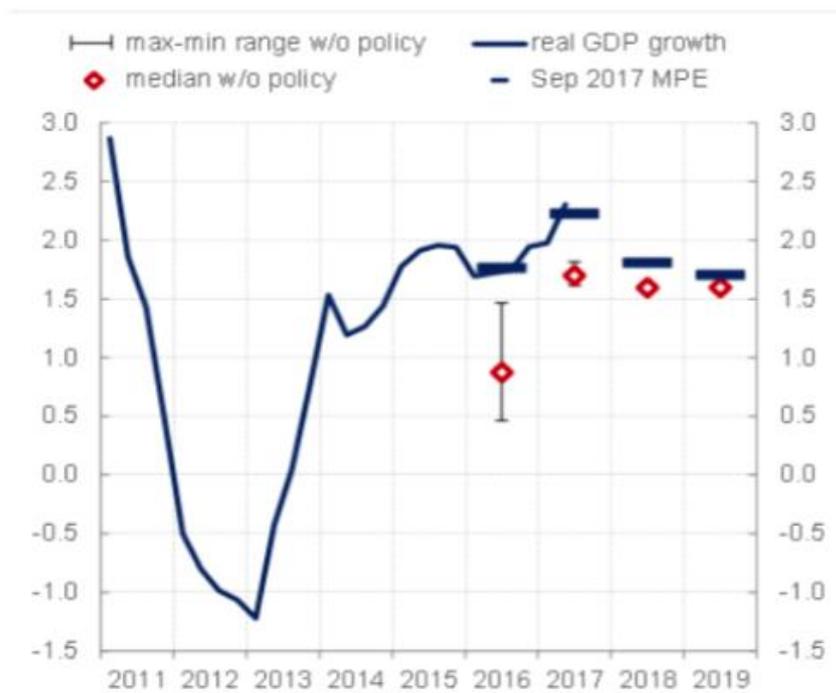
Chart 1: Impact of ECB measures on key financing conditions



(contributions in basis points and percent)

Source: Bloomberg, ECB, ECB calculations. [1]

Chart 2a: Real GDP growth: actual, baseline projection and counterfactual without policy contribution



(year on year percentage change)

Chart 2b: HICP inflation: actual, baseline projection and counterfactual without policy contribution



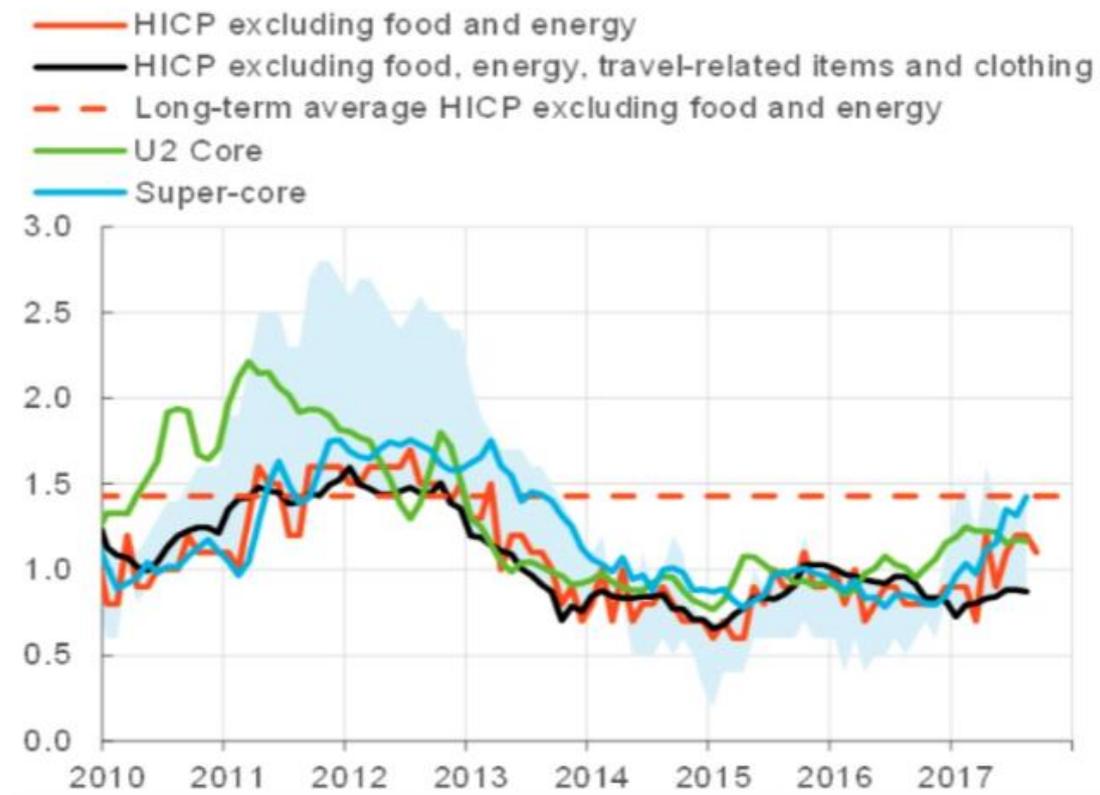
(year on year percentage change)

Sources: ECB computations, SAPI Task Force, September 2017 MPE, BMEs. [2]

Table 1: Comparison of forecasts for euro area real GDP growth

	Publication date	GDP growth						HICP inflation					
		2017		2018		2019		2017		2018		2019	
ECB staff (MPE)	07 Sep 2017	2.2	(+0.3)	1.8	(-)	1.7	(-)	1.5	(-)	1.2	(-0.1)	1.5	(-0.1)
Consensus Economics	14 Sep 2017	2.1	(+0.1)	1.8	(+)	1.4	(+0.1)	1.5	(+)	1.3	(+)	1.7	(+0.1)
OECD	07 Jun 2017	1.8	(+0.2)	1.8	(+0.2)	-	-	1.7	(+0.5)	1.4	(=)	-	-
Euro Zone Barometer	22 Sep 2017	2.1	(+0.1)	1.8	(+)	1.5	(+)	1.5	(-0.1)	1.3	(-0.1)	1.7	(+)
European Commission	11 May 2017	1.7	(+0.1)	1.8	(=)	-	-	1.6	(-0.1)	1.3	(-0.1)	-	-
ECB SPF	21 Jul 2017	1.9	(+0.2)	1.8	(+0.2)	1.6	(+0.1)	1.5	(-0.1)	1.4	(-0.1)	1.6	(-0.1)
BMF	10 Oct 2017	2.1	(+0.2)	1.9	(+0.2)	1.7	(+0.1)	1.5	(-0.1)	1.4	(-0.1)	1.7	(=)

Chart 3: Measures of underlying inflation



(annual percentage changes)

Sources: Eurostat and ECB calculations. [5]

Fonte: Bank For International Settlements (BIS)

<http://www.bis.org/review/r171018c.htm>

Mario Draghi: Structural reforms in the euro area

Introductory remarks by Mr Mario Draghi, President of the European Central Bank, at the ECB conference "Structural reforms in the euro area", Frankfurt am Main, 18 October 2017

* * *

It is my pleasure to welcome you all to this conference on structural reforms in the euro area.

As you know, “structural reforms” has become something of a contested term in recent years. For many, it describes a pragmatic policy agenda to raise long-term growth and accelerate adjustment to shocks, which is essential for countries in a monetary union.

But for others, the term is viewed as a “catch-all” for a wide range of policies, some of which have potentially negative short-run costs and adverse distributional effects.

In view of these discussions, it is important to assess – first – whether countries with more flexible structures and more resilient institutions do indeed recover more quickly from shocks and grow faster over the cycle.

Second, we should evaluate how the design of reforms and the overall policy mix affect the impact of structural policies, especially during a downturn.

And third, we should assess the distributional effects of reforms, and consider how we can ensure that they benefit everyone in society.

These are the themes I will focus on in my remarks this morning.

Economic structures, adjustment to shocks and long-term growth

First of all, the crisis has helped us better understand a key question for the euro area: are economies that are more flexible also more resilient to adverse shocks, and do they experience faster recoveries and higher long-term growth?

By and large, the experience of the crisis has shown the answer to be “yes”. What we have seen is that more economic flexibility and sound institutions do lead to more resilience and higher long-term growth, including when countries face a common shock.

Indeed, euro area economies that were more flexible at the start of the crisis – as measured by the World Bank Doing Business Indicator in 2009 – subsequently showed a stronger recovery. GDP per capita rebounded faster and unemployment fell more. [1]

And looking at the last 15 to 20 years – so over the full cycle – euro area countries with sound economic structures at the outset have shown much higher long-term real growth.

Confirming this relationship, countries that reformed their product and labour markets during the crisis have also seen good results afterwards – and the full effects are still materialising.

Focusing just on the labour market, a number of countries have implemented reforms in recent years which have helped to reduce unemployment – most visibly Spain and Portugal, but also Italy. [2] These reforms also seem to have made unemployment more responsive to growth. [3]

Structural policies are a main factor explaining these positive developments. But of course supportive financial and macroeconomic policies have been vital, too.

New research also finds that labour market reforms in the euro area reduce the dispersion of unemployment and GDP across member countries following a common shock, making the single monetary policy more effective for everyone. [4]

But it is clear that, to get the best results, there has to be some broad coordination among countries. Labour market reforms can emphasise more wage adjustment or more employment adjustment, and countries will only converge in their response to shocks if they have a broadly similar mix. [5]

This underscores why the European Semester process is crucial – not only for encouraging structural reforms, but also for ensuring some degree of beneficial consistency between them.

Lessons on the composition of reforms and their interaction with macro policies

Still, even if some countries have had positive experiences with reforms during the crisis, we know that for others it has been more difficult. This brings me to my second theme about the design and implementation of reforms.

There are three key areas where lessons can be drawn: the packaging of reforms, their scope and the macro-policy mix that accompanies them.

First, the packaging of reforms is crucial for reducing their short-term adjustment costs.

Unlike what happened in the years even before the crisis, labour market reforms must be preceded – or least accompanied by – product market reforms, otherwise wage adjustments will not be fully passed on to prices. Instead, profit mark-ups will rise and the purchasing power of households will fall, thereby worsening the economic conditions of consumers and aggravating any recession. [6]

During the crisis, because of powerful vested interests, labour market reforms were not accompanied by product market reforms in some countries, and so wages fell and prices did not adjust in tandem.

The key question is then: how do we make sure that product market reforms do indeed take place? While there are no easy answers, IMF research suggests a central part of the answer may be carefully designed fiscal incentives to soften the blow for those affected. In the past, Germany, Ireland and the UK have all successfully used such incentives to bring about these reforms. [7]

The second area where we have learned lessons from the crisis is the scope of reforms.

Much of the focus in the reform debate has been on product and labour markets. But what is often forgotten is the scope for progress by reforming public administration and the business environment.

These reforms are effective at all points of the cycle, since they entail very few short-term costs. In fact, lessening the time it takes to open a business, or speeding up judicial processes, should yield immediate net gains. And institutional reforms also act as a multiplier for other reform efforts by improving the implementation and enforcement of those measures.

In light of this, many countries have successfully introduced more broad-based reforms during the crisis. But there are still large gains that could be achieved.

Published research and internal Eurosystem simulations show that improved economic structures and institutions could result in significantly higher GDP in the long run, depending on the specific reforms and approach used. [8] It has also been estimated that sound economic structures could reduce the probability of a severe recession by around 20%. [9]

The final area where we have learned about reform strategy is the overall policy mix.

The crisis has lent weight to the view that a supportive macro-policy mix leads to improved reform implementation. [10] The IMF finds that, where countries have fiscal space, temporary public spending can ease the transitional costs of some reforms. This is then paid for in the medium term when the growth benefits of those reforms kick in and fiscal positions improve. [11]

Fiscal incentives have also been shown to improve the effectiveness of reforms. The Italian “Jobs Act” in 2015, for example, has been followed by an increase of almost half a million in the number of people employed with a permanent job contract, in large part because hiring subsidies encouraged firms to take on more people under the new open-ended contract. [12]

Perhaps more controversial in recent years has been the question of the interaction between monetary policy and structural reforms. It is often said that monetary policy discourages reforms by taking the pressure off governments to act during crisis times.

But ECB research finds no convincing evidence that high interest rates lead to more reforms, if one controls for the business cycle and other factors. In fact, the opposite is more likely to be true: lower rates tend to promote reforms, since they lead to a better macroeconomic

environment. [13] This is especially useful for countries without the fiscal space to support demand.

The challenge of pairing reforms with inclusiveness

But we have also learned something else from the crisis: highlighting the benefits of reforms in terms of growth is not enough to make them widely acceptable to the public. We also need to take into account the inclusiveness of economic policies.

As we all know, there is an increasing perception that growth in the past has not been sufficiently inclusive, and was not always associated with rising living standards for everyone. This has fuelled the belief that some have been “left behind” by the spread of market forces.

In this context, the case for structural reforms needs to go beyond their efficiency benefits. We need to show that reforms can contribute to both efficiency and equity.

One way this can be achieved is by focusing more on reforms with positive distributional effects.

Tackling rent-seeking in some product markets tends to benefit those at the lower end of the income scale, since such reforms lead to lower prices and increased consumption choices, and therefore improve the welfare and purchasing power of poorer people in particular. [14]

Addressing tax avoidance and evasion would also help reduce inequality. Indeed, the payoff of efforts in this area can be significant. In 2015, EU countries lost around 12% of total expected revenues in value-added tax, partly because of tax evasion and inadequate tax collection systems. [15]

Still, some reforms will always have negative distributional effects, at least in the short term.¹⁶ But in these cases we can do more to reduce inequality by ensuring that flexibility is

combined with security. Inclusive labour markets are ones with well-functioning active labour market policies that allow people to reskill, and proactive macroeconomic policies that shorten job transitions.

Before the crisis, several countries introduced labour market reforms to increase flexibility, but did little to make their labour markets more secure. This ended up disproportionately penalising young people, who had weak job protections and meagre support during unemployment.

As I said in a recent speech in Ireland, young people do not want to live on subsidies. They want to work and expand their lifetime opportunities. [17] So we should never think that simply compensating the “losers” of reforms is enough. Public policies have to be designed to help people back into work, and into jobs where they can develop and refine their skills.

Given the ongoing polarisation of skills in labour markets, this points to the crucial importance of strong education and training systems. Job polarisation is not just putting increasing pressure on workers with mid-level skills, but also complicating the possibilities for unskilled workers to find more skilled jobs, meaning that they continue to be trapped in low-paid jobs. [18]

The main answer is education and training that disseminates marketable skills more widely. Otherwise, there is a risk that, rather than being seen as an agent of jobs and opportunity, structural reforms are seen as a catalyst for a low-wage, precarious economy.

Conclusion

Let me sum up.

The crisis has confirmed that more flexible economies are more resilient, especially for countries that are part of a monetary union. Lessons about how to design and implement reforms so as to maximise their benefits and minimise their short-term costs should be put into practice.

Reforms have to take into account equity as well as efficiency. Vested interests have to be tackled and those who have lost out given proper support.

With monetary policy being accommodative, we now have a window of opportunity to take these measures. I hope the insights at this conference can move this agenda forward.

[1] This holds true for both the countries that joined the euro area early on (by 2001) and the former communist countries that joined later. However, for a given “Doing Business” level (World Bank measure of business regulations) the latter group seem to have generally outperformed the former, possibly due to their larger catching-up potential.

[2] See Banco de España (2015), “Competitive adjustment and recovery in the Spanish economy”, Annual Report, Box 2, pp. 39-63; Vansteenkiste, I. (2017), “Did the crisis permanently scar the Portuguese labour market? Evidence from a Markov-switching Beveridge curve analysis”, Working Paper Series, No 2043, ECB, Frankfurt am Main, April; and Sestito, P. and Viviano, E. (2016), “Hiring incentives and/or firing cost reduction? Evaluating the impact of the 2015 policies on the Italian labour market”, Questioni di economia e finanza (Occasional Papers), No. 325, Banca d’Italia, March.

[3] Based on a static relationship between changes in the employment rate and percentage changes in GDP for the period between the first quarter of 1999 and the second quarter of 2015. The period of the recovery analysed is from Q2 2013 to Q2 2015. See the article entitled “What is behind the recent rebound in euro area employment?”, Economic Bulletin, Issue 8, ECB, 2015.

[4] Calculations based on estimation results from Abbritti, M. and Weber, S. (forthcoming), "Reassessing the Role of Labor Market Institutions for the Business Cycle," *International Journal of Central Banking*.

[5] Abbritti, M. and Mueller, A. (2013), "Asymmetric Labor Market Institutions in the EMU and the Volatility of Inflation and Unemployment Differentials," *Journal of Money, Credit and Banking*, Vol. 45(6), pp. 1165-1186.

[6] See Blanchard, O. and Giavazzi, F. (2003), "The Macroeconomic Effects of Regulation and Deregulation in Goods and Labor Markets", *The Quarterly Journal of Economics*, Vol. 118, August, pp. 879-907.

[7] Banerji, A. et al. (2017), "Labor and Product Market Reforms in Advanced Economies: Fiscal Costs, Gains, and Support", *IMF Staff Discussion Note*, March.

[8] Simulations based on ECB staff research (Masuch, K., Moshhammer, E. and Pierluigi, B. (2016), "Institutions, public debt and growth in Europe", Working Paper Series, No 1963, ECB, Frankfurt am Main, September) show that enhancing institutions towards average practices in the EU could lift long-term real GDP per capita for some countries by between 5% and 18% (in the course of about ten years).

[9] Sondermann, D. (2016), "Towards more resilient economies: the role of well-functioning economic structures", Working Paper Series, No 1984, ECB, Frankfurt am Main, November.

[10] For an early example of this view, see Gordon, R. (1996), "Macroeconomic Policy in the Presence of Structural Maladjustment", *NBER Working Paper Series*, No 5739, National Bureau of Economic Research, September.

[11] Banerji, A. et al., op. cit.

[12] Between the first quarter of 2015 and the first quarter of 2017, see Eurostat's European Union Labour Force Survey. See also Sestito, P. and Viviano, E. (2016), "Hiring incentives and/or firing cost reduction? Evaluating the impact of the 2015 policies on the Italian labour market", *Questioni di economia e finanza (Occasional Papers)*, No. 325, Banca d'Italia, March.

[13] Dias Da Silva, A., Givone, A. and Sondermann, D. (2017), "When do countries implement structural reforms?", Working Paper Series, No 2078, ECB, Frankfurt am Main, June.

[14] For more on this mechanism, see Fajgelbaum, P. D. and Khandelwal, A. K. (2014), "Measuring the unequal gains from trade", *NBER Working Paper Series*, No 20331, National Bureau of Economic Research, July.

[15] Center for Social and Economic Research (2017), "Study and Reports on the VAT Gap in the EU-28 Member States: 2017 Final Report".

[16] The OECD finds that: “Social protection and labour market reforms are the sources of most of the trade-offs between growth and equity objectives. Reductions in the generosity of unemployment benefits and social assistance are found to leave poor households behind” (see Causa, O., Hermansen, M. and Ruiz, N. (2016), “The distributional impact of structural reforms”, Economics Department Working Papers, No 1342, Organisation for Economic Co-operation and Development, November).

[17] Draghi, M. (2017), “Youth unemployment in the euro area”, speech for the Henry Grattan Lecture Series at Trinity College, Dublin.

[18] OECD Employment Outlook 2017.

Fonte: Bank For International Settlements (BIS)

<http://www.bis.org/review/r171019a.htm>