

PART II
Chapter 4

Can structural reforms kick-start the recovery? Lessons from 30 years of OECD reform¹

Not much is known about the short-term effects of structural reforms whose benefits are expected in the long term. It has been argued that some reforms could be detrimental at the current juncture, for instance if they further weakened aggregate demand. This chapter presents new empirical analysis drawn from 30 years of reform data from OECD countries. It shows that, while their benefits usually take time to fully materialise, structural reforms seldom involve significant losses and often deliver gains already in the short run. At the same time, though, some of them, such as unemployment benefit and job protection reforms, have smaller or even negative effects in depressed economies. Current conditions of wide remaining spare capacity, constrained macroeconomic policies and impaired fiscal positions in most OECD countries would put a premium on reforms that offer comparatively strong short-term gains in terms of facilitating the jobs recovery:

- In all countries, there is a case for sheltering resources devoted to active labour market policies from ongoing fiscal consolidation efforts. Strengthening job-search assistance and training can help job seekers find new jobs more quickly and ensure that those at risk of discouragement remain attached to the labour market.
- Growth-friendly tax reforms that shift the tax burden away from labour taxes could help strengthen the jobs content of a recovery, while also helping fiscal consolidation insofar as they are implemented in a way that raises tax revenue.
- A well-designed package of labour and product market reforms could help alleviate the potential transition costs of certain individual reforms. Supporting reforms with a well-functioning financial system and an effective communication strategy is another key for maximising short-term gains.

Summary and conclusions

This chapter attempts to shed light on how the impact of structural reform varies across different types of reform as well as over time, identifying the horizon over which their full effects materialise, and investigating how such effects may depend on a country's economic conditions. These issues are especially important in the current economic context; indeed at a time when spare capacity remains high in many OECD countries and macroeconomic policies are constrained (Chapter 1), there is a premium on reforms that would help kick-start the recovery.

The benefits of structural reforms – typically aimed at increasing labour productivity or employment – often take time to materialise, and their short and long-term impacts may differ. Many long-term gains can involve transition costs, due for instance to the disappearance of firms and associated layoffs in the wake of product market liberalisation, or because it takes time for capital to find new productive uses and for workers to find new jobs when reforms involve reallocation (Blanchard and Giavazzi, 2003). On the other hand, some structural reforms can boost growth quickly; for instance, if they improve confidence and increase expected future income gains, they can immediately stimulate consumption and investment. Likewise, forward-looking financial markets can incorporate healthier longer-term economic prospects – and therefore the effects of reforms – into asset prices, thereby further stimulating near-term activity.

This chapter draws on new OECD empirical analysis of the short-term effects of product market, labour market and taxation reforms to highlight a number of lessons for policy:

- The benefits from reforms often take time to materialise.
- Concerns about possible negative short-term effects of structural reforms seem exaggerated, however. Some structural reforms appear to boost growth fairly quickly, while usually very few if any have short-term costs.
- Because reforms do not turn out to have noticeable deflationary effects, the analysis does not support the need for significant monetary and fiscal accommodation to speed up the gains from reforms.
- Cyclical conditions matter for the short-term effects of reforms. There is some evidence that in “bad times”, certain labour market reforms (of unemployment benefit systems and job protection in particular) can make the economic situation temporarily worse. In still depressed economies, such reforms would therefore be more quickly beneficial if carried out only once the labour market shows clear signs of recovery.
- In view of wide remaining spare capacity, constrained macroeconomic policies and impaired fiscal positions in most OECD countries, policy priority should be given to reforms that offer comparatively strong short-term gains, especially in terms of strengthening the jobs recovery:
 - There is a case for sheltering resources devoted to *active labour market policies* (ALMPs) from ongoing fiscal consolidation efforts in all OECD countries. Strengthening ALMPs,

- particularly on training and job search, can help job seekers find new jobs more quickly and ensure that those at risk of discouragement remain attached to the labour market.
- *Growth-friendly tax reforms* that shift the tax burden away from labour towards consumption, the environment, and – as housing markets allow – immovable property appear to reduce unemployment relatively quickly, particularly for young people, and also stimulate private investment.
 - To encourage the job content of the recovery, there is case for *product market reforms* that ease entry barriers in certain services, especially retail trade and professional services. This is especially the case in continental and southern European countries.
 - A well designed *package* of labour and product market reforms would deliver the largest gains and alleviate the transitional costs of certain individual reforms – for instance, liberalising product markets alongside job protection or unemployment benefit reforms can mitigate possible real wage declines associated with the latter.
 - The short-term impact of structural reforms will be stronger if an effective communication strategy and a strong and well-regulated banking sector foster confidence and induce households and firms to spend against future reform-driven income gains.
 - Some reforms can help fiscal consolidation by strengthening public budgets, either directly or indirectly via higher output and employment. For example, unemployment benefit and pension reforms directly improve fiscal balances, while gradually delivering employment gains that further raise tax revenue and reduce public spending. Expectations of enhanced long-term debt sustainability can reduce government borrowing costs and thereby help stimulate the economy.

The broad driving factors of the short-term effects of reforms

The demand and supply effects of reforms

Structural reforms are typically aimed at increasing labour productivity or employment over the long run (see Chapter 1 and past *Going for Growth* editions). However, their effects may not materialise immediately, depending in part on their short-term impact on aggregate demand in relation to supply and the macroeconomic policy response.

Demand channels...

Structural reforms may affect aggregate demand in several ways. One such channel is the “*multiplier effect*” associated with their impact on the fiscal balance.² Unfinanced costly reforms are likely to have more positive short-run effects on demand than revenue-raising reforms. For example, absent any offsetting schemes, increasing spending on ALMPs is likely to stimulate aggregate demand in the short run, whereas reducing unemployment benefits is likely to depress it. The multiplier effects of costly reforms are likely to be higher when such reforms are associated with spending increases or revenue reductions that fall mainly on domestic goods, such as increases in government spending on education and infrastructure. Likewise, the demand effect of revenue-raising reforms depends on whether and how the revenue is spent. For example, the potential negative effect of a cut in unemployment benefits on disposable income will be attenuated by simultaneously introducing offsetting fiscal measures (*e.g.* a tax cut for low income earners).

The positive or negative impacts of reforms on demand also depend on how they affect *confidence, income and wealth*:

- *Positive confidence, income and wealth effects* may result from reform-driven changes in future incomes. The positive effects of structural reforms on future income may be incorporated into household's perceptions of permanent income. They may also be reflected into forward-looking asset prices, and therefore in household wealth.³ In turn, higher asset prices may ease credit constraints via improved collateral, thereby further boosting consumption and investment. In this regard, a well-functioning financial sector is instrumental for bringing forward the gains from reforms, since it allows households and firms to borrow against future income or collateral.⁴
- *Permanent income effects* should most often be positive but reform design also plays a role. For instance, a pension reform that cuts future replacement rates may reduce aggregate consumption in the short run insofar as some households seek to save more to make up for reduced retirement income in the future. By contrast, a pension reform that increases the minimum or standard retirement age may stimulate consumption as households expect to work over a longer time horizon and hence can reduce saving while maintaining their future living standards (Kerdrain *et al.*, 2010).
- *Negative confidence effects* may arise from households' perception of higher income insecurity in the wake of certain reforms, leading to higher *precautionary savings* and lower demand. For instance, reducing job protection might adversely affect households' consumption by increasing labour turnover and job insecurity, even if such reform does not trigger higher overall unemployment and increases exit rates from unemployment.

Positive demand effects are more likely insofar as an effective communication strategy gives households and firms clear and timely information about reform implementation and its expected benefits. Clear communication can reduce the risk of reform-driven increases in precautionary savings and induce economic agents to spend in anticipation of future incomes. Also, announcing reforms (*e.g.* product market liberalisation) in advance can trigger immediate response by firms, accelerating the upside adjustment in investment and output even before the reform is actually implemented.⁵ A related argument can be made about reform credibility. Reforms that are introduced with broad political support and strong government commitment will solicit a greater and faster response of the economy as they are less likely to be rolled back.

The short-term demand effects of structural reforms might also depend on countries' degree of openness. Greater trade openness can dampen any demand impact of reforms on the economy because imports will change while exports will be unaffected. Furthermore, insofar as reforms reduce domestic prices and thereby improve external price competitiveness, the associated boost to aggregate demand will be larger for smaller, more open economies.

... and supply channels

The effects on supply, and in particular on productivity, are typically long term. However, the time it takes to reap such benefits may differ across reform areas depending on a number of factors:

- *Measures to stimulate knowledge and innovative activities*, such as education reforms and innovation policies, require a long time to deliver their full benefits.⁶ It also takes time for product market liberalisation to encourage firms to adopt new technology.

- Reforms that raise productivity through *reallocation* of production factors may also payoff only gradually. One example is the productivity impact of job protection (Bassanini *et al.*, 2009). Another is rental housing market liberalisation that promotes workers' mobility, leading to labour reallocation across firms, industries and geographical areas.
- Reforms that reduce *inefficiencies* in firms and industries can have a more immediate positive impact on labour productivity. Efficiency-enhancing public sector reforms that succeed in reducing slack in certain publicly-run industries or state-owned enterprises may fall into this category. Similarly, the productivity gains associated with trade liberalisation and product market reform are likely to materialise more quickly in industries where incumbents are relatively inefficient.

... which result in a priori-ambiguous effects of reforms

New OECD analysis based on a theoretically coherent but simplified economic model illustrates how the short-term effects of reforms depend on whether the demand or the supply channels dominate (Cacciatore *et al.*, 2012). Short-term effects depend in particular on the relative impact of reforms on lay-offs *versus* job creation. For example:

- *Job protection reforms* are predicted to increase lay-offs more quickly than they boost job creation, and thereby temporarily result in higher unemployment.
- Temporary labour market slack can also follow *product market liberalisation*. Labour shedding is immediate, while it may take time before new firms are created and the displaced workers find a new job.
- *Unemployment benefit reforms* appear to reduce unemployment even in the short run, because they increase job creation without affecting job losses.

Model-based results need to be interpreted with care though, as the analysis cannot feature all possible demand channels, and in particular the potential increases in precautionary savings associated with certain reforms. This effect would result in more negative or less positive short-run effects, for instance in the case of unemployment benefit reforms to the extent that the latter increase income insecurity.

... which reform packages can help turn unequivocally positive

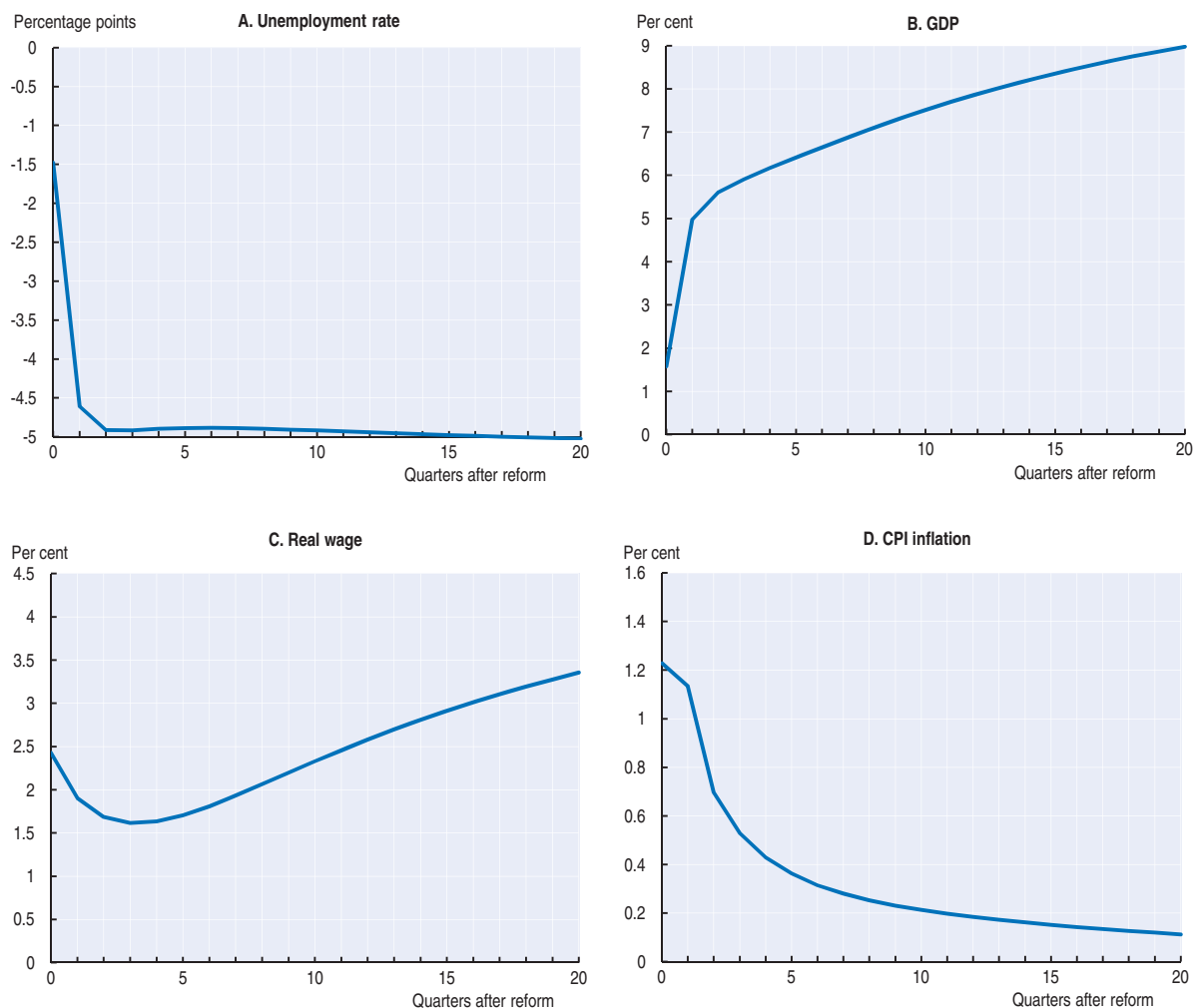
The OECD model-based analysis points to sizeable gains from undertaking structural reforms simultaneously in different areas (Cacciatore *et al.*, 2012). Combining product market, job protection and unemployment benefit reforms appears to have the potential to boost GDP, employment and wages immediately, in contrast with the effects of some of these reforms in isolation. In particular, reducing entry barriers in product markets in parallel to labour market reforms alleviates the real wage losses that would result from the latter alone. More broadly, compared with individual reforms, a broad package yields larger income and employment gains, the expectation of which gives an immediate boost to aggregate demand and job creation. Keeping in mind that model-based simulations are necessarily stylised, Figure 4.1 illustrates that the short-term gains associated with a broad reform package can be substantial.

The role of macroeconomic policies

Structural reforms that change the output gap – defined as the difference between the level of current (observed) output and the level of “potential” (unobservable) *post-reform* output – and inflation should in principle trigger a macroeconomic policy response. In


Figure 4.1. **The sizeable short-term economic gains from an ambitious package of structural reforms**

Model simulation of the short-term impact of a reform package combining a decline in entry barriers, a reduction in the unemployment benefit replacement rate and a relaxation of job protection in a hypothetical “rigid” economy (gaps with respect to no reform)



Note: The size of the simulated reform corresponds to a reduction in the value of each policy parameter from a hypothetical “rigid” economy to a hypothetical “flexible” economy (calculated as an average of “flexible” OECD countries). The composition of the basket of benchmark OECD countries is slightly different across policy parameters. See Cacciatore *et al.* (2012) for details.

Source: Cacciatore, M., R. Duval and G. Fiori (2012), “Short-term Pain or Gain? A DSGE Model-based Analysis of the Short-term Effects of Structural Reforms in Labour and Product Markets”, *OECD Economics Department Working Papers*, OECD Publishing, forthcoming.

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particular, when reforms raise supply more than demand and hence create economic slack, expansionary monetary and fiscal policies can strengthen their short-term effects. Otherwise, the gains from reforms would come through more gradually as the excess supply in goods or labour markets puts downward pressure on price and wage inflation. In practice, however, model-based analysis does not support the need for such macroeconomic policy support because it does not find structural reforms to have noticeable deflationary effects (Cacciatore *et al.*, 2012). This suggests that in practice monetary authorities may not face the so-called “paradox of toil” (Eggertsson, 2010).⁷ This

hypothetical situation might arise when, because already-low interest rates cannot fall below zero, a reform-driven increase in supply lowers prices, raises the real interest rate and thereby ultimately depresses rather than stimulates the economy.

The finding that structural reforms do not generally call for much macroeconomic easing naturally extends to fiscal policy. Structural reforms may even have positive feedback effects on the economy via their effect on public finances and long-term interest rates. Indeed reforms that reduce fiscal sustainability concerns and therefore the perception of sovereign risk (e.g. pension reforms, reductions in government consumption through enhanced efficiency of public spending in health or education) may lead to a decline in interest rate *premia* which in turn may boost short-term growth, *ceteris paribus* (Giavazzi and Pagano, 1990).⁸

The short-term effects of structural reforms in practice: New evidence from 30 years of reform in OECD countries

Given existing uncertainties regarding the short-term impact of reforms, the OECD has conducted new empirical analysis to shed light on the actual dynamic effects of past product market, labour market and tax reforms on aggregate output and labour utilisation. The analysis first identifies a broad range of structural reform “shocks” that were implemented OECD countries during the 30 years prior to the recent financial crisis and then estimates their economic effects over a five-year horizon (for methodological details, see Box 4.1). This section summarises the main results of the analysis and attempts to interpret them in light of the underlying channels of transmission discussed above.

Box 4.1. Methodology: an overview

Based on roughly 30 years of data from 30 OECD countries prior to (but not including) the recent crisis, the analysis involved the following steps:

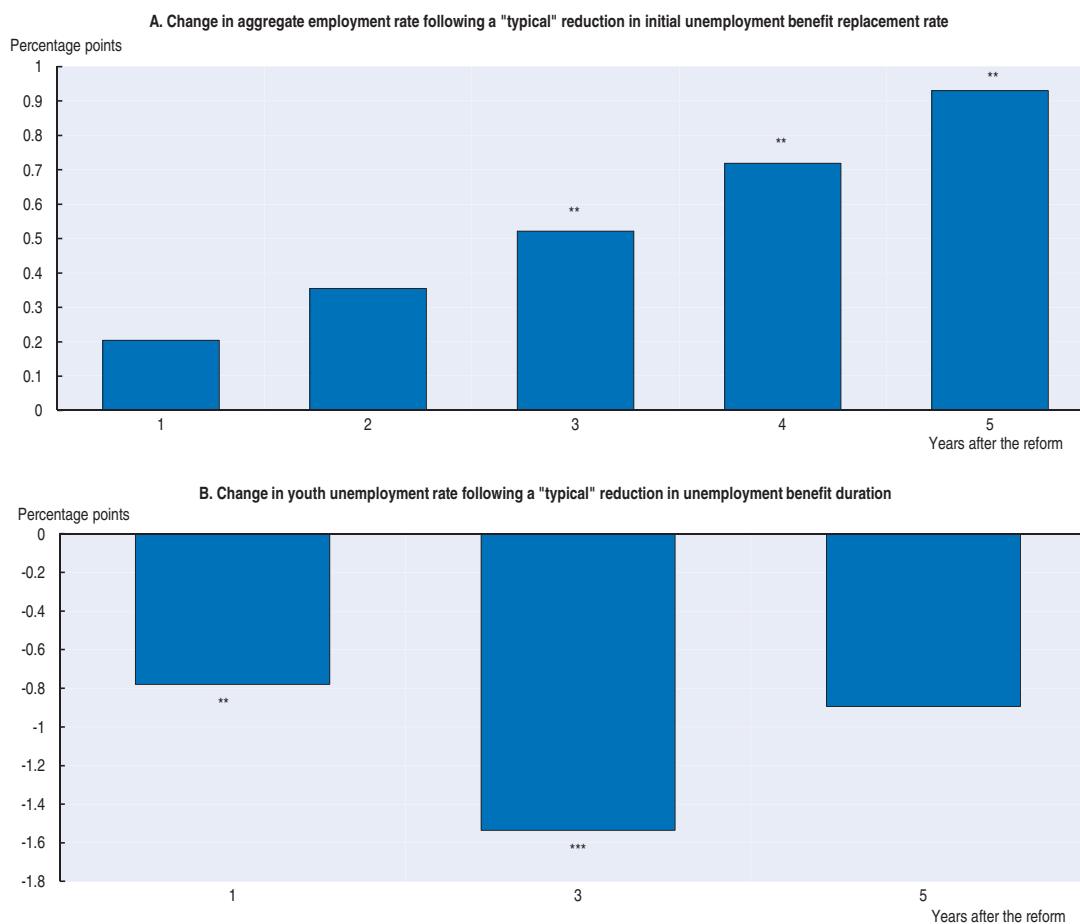
- Structural reform “shocks” were identified from the cross-country time-series variation in existing OECD policy indicators in the following areas: unemployment benefit systems, labour taxes, job protection, ALMPs, product market regulation, administrative extensions of bargaining agreements and the tax structure (for details, see Table 1 in Bouis *et al.*, 2012).
- For each reform, the average impact in the five years following its implementation was estimated for: i) overall GDP, as well as employment and unemployment; ii) various components of aggregate demand, in particular private consumption and investment, in order to better identify the components driving the aggregate effects; and iii) specific population groups (young people, prime-aged, women and seniors), as these are likely to behave differently in the labour market and thus to be differently affected by structural reforms. An attempt was also made to estimate whether the short-term impact of a reform depends on the other policy and institutional features of the country considered. For example, do the short-term effects of labour market reforms differ across countries depending on whether their product market regulation is more or less conducive to strong competition?
- The analysis then explored whether the short-term impact of a reform shock depends on cyclical conditions in that country when the reform was implemented. For example, did the differences in the short-term effects of labour market reforms across countries depend on whether labour markets were tight or slack (i.e. on the unemployment gap, measured as the difference between the actual and “structural” levels of unemployment)?

Labour market and welfare reforms

The analysis suggests that the short-term effects of labour market and welfare reforms are mostly positive or null. There is no evidence of aggregate costs of these reforms – although there may have been distributional consequences which go beyond the scope of this paper (see Chapter 5 on the income distribution effects of labour market policies and institutions). The main findings can be summarised as follows:

- *Unemployment benefit* reforms are found to deliver fairly quick positive impacts on labour utilisation, contrary to fears that they may weaken consumption in the short run. The estimated increase in employment following an 8 percentage point reduction in the initial replacement rate – corresponding to the median reform over the three decades considered in the study – reaches almost 0.5 percentage points on average after three years (Figure 4.2, Panel A). This finding echoes the model-based predictions mentioned

Figure 4.2. **Unemployment benefit reforms can have a fairly quick positive impact on labour utilisation**



Note: *** and ** represent statistical significance at the 1 and 5% levels, respectively. The simulation is based on the median-sized reform observed in the estimation sample. In Panel B, the impact of the reform is estimated controlling for the initial unemployment benefit replacement rate.

Source: Bouis, R. et al. (2012), "The Short-term Effects of Structural Reforms: an Empirical Analysis", OECD Economics Department Working Papers, OECD Publishing, forthcoming.

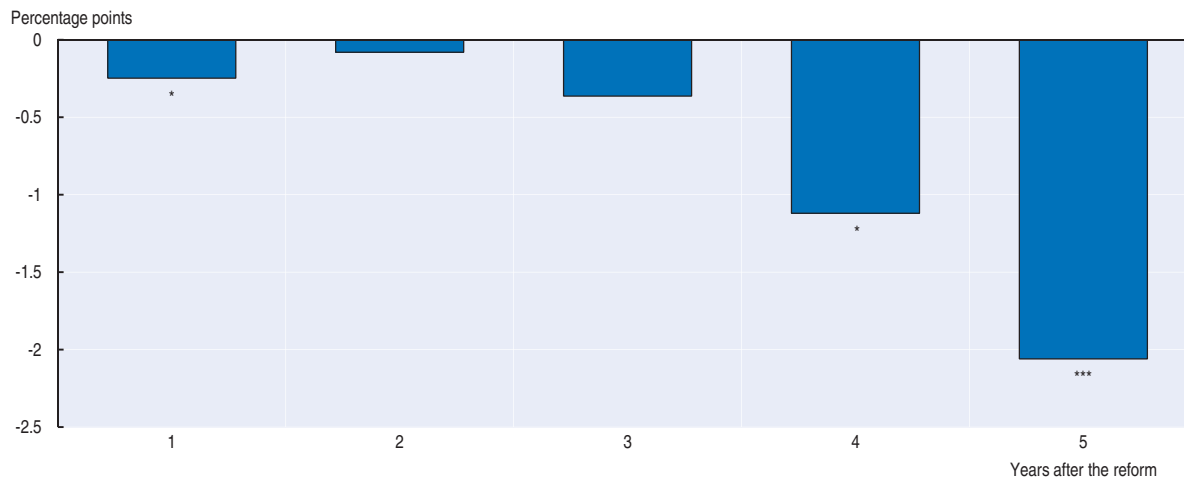
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above (see also Cacciatore *et al.*, 2012), and could reflect the fact that lower unemployment benefits boost job creation by increasing jobseekers' incentives to actively look for a job and return to work (see *e.g.* Bassanini and Duval, 2006) but do not increase job destruction. Reductions in benefit duration are found to be followed by quick declines in unemployment particularly for young people (Figure 4.2, Panel B). As an illustrative example, the estimates suggest that a decrease in benefit duration similar to that implemented in Denmark in 2001 – corresponding approximately to the median reform over the past three decades – may reduce the unemployment rate of young people by more than 1½ percentage points after three years in the average OECD country. Consistent with their employment effects, benefit reforms are also found to be associated with stronger investment and output growth.

- At the same time, however, unemployment benefit reforms seem to have negative short-term effects on specific groups of the labour force, in particular older workers. For instance, reducing unemployment benefit duration seems to be associated with a reduction in senior employment. Where older age groups are over-represented among the long-term unemployed, this effect may be driven by labour force withdrawal – possibly coupled with a move to early retirement in countries where this has been possible.
- Short-run employment gains associated with unemployment benefit reforms are found to be stronger where job protection is weak. This result could suggest that stringent job protection might prevent labour demand, in particular firms' hiring decisions, from responding fully to the potential increase in effective labour supply arising from unemployment benefit reforms.
- Based on a handful of reform experiences, it seems that *reducing job protection on regular contracts* has no significant effects on aggregate employment, consistent with priors. Still, there is tentative evidence that job protection reforms may reduce unemployment in the short run, especially for certain marginal categories of the labour force such as young people and women, who may enjoy better relative job prospects from a relaxation of regular contract provisions.
- *Reducing job protection on temporary contracts*, a frequent reform in OECD countries over the past three decades, is found to reduce employment in the years following the reform. The initial decrease in the overall employment rate is 0.2 percentage points, reaching 2 percentage points after five years (Figure 4.3). This broadly confirms previous analysis, including by the OECD, which highlighted the weaknesses of *two-tier reforms of job protection*, *i.e.* reforms aimed at reducing job protection on temporary contracts while maintaining stringent provisions for regular workers.⁹ As well as having negative employment effects, these reforms are also associated with lower GDP, consumption, and investment growth rates.
- *Strengthening active labour market policies (ALMPs)* through better job search services and stronger enforcement of conditionality *vis-à-vis* jobseekers could in principle reduce unemployment by facilitating short-run job creation. Such gains are difficult to identify empirically because ALMPs reforms can only be measured by changes in expenditures, and the latter are driven more by cyclical conditions than by institutional changes. The analysis attempted to address this issue by removing the cyclical component from the associated policy indicators and by focusing on those public spending categories which are

less sensitive to the economic cycle. The corresponding results suggest that, indeed, increases in spending on employment incentives (Figure 4.4), as well as on training, increase employment in the short term – particularly among women as regards training measures.

Figure 4.3. The failure of two-tier job protection reforms to raise employment
Change in aggregate employment following a “typical” reduction in job protection on temporary contracts



Note: *** and * represent statistical significance at the 1 and 10% levels, respectively. The simulation is based on the median-sized reform observed in the estimation sample.

Source: Bouis, R. et al. (2012), “The Short-term Effects of Structural Reforms: an Empirical Analysis”, OECD Economics Department Working Papers, OECD Publishing, forthcoming.


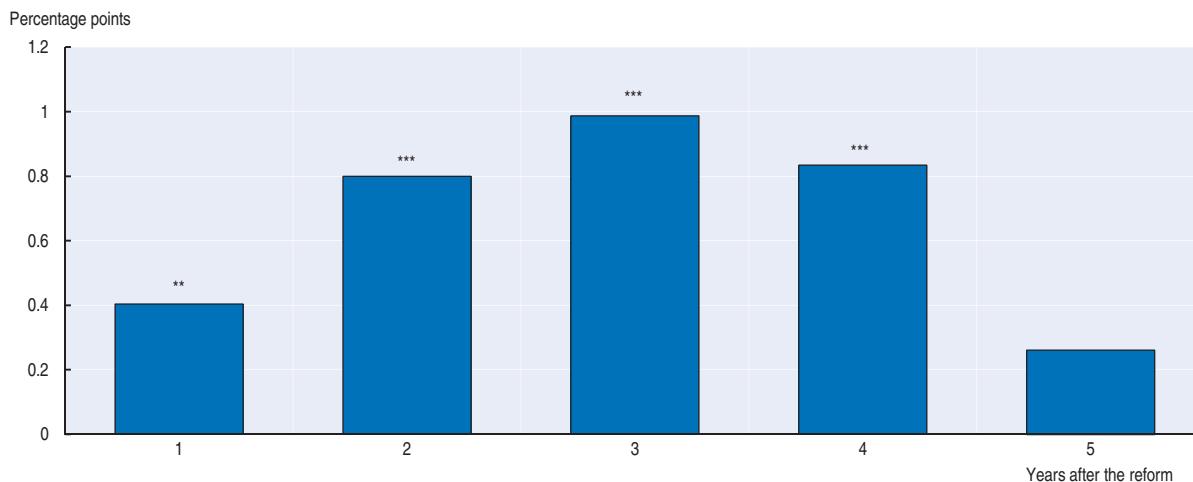
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Figure 4.4. How strengthening active labour market policies can help strengthen the jobs recovery

Change in aggregate employment rate following a “typical” increase in public spending on ALMP employment incentives



Note: *** and ** represent statistical significance at the 1 and 5% levels, respectively. The simulation is based on the median-sized reform observed in the estimation sample.

Source: Bouis, R. et al. (2012), “The Short-term Effects of Structural Reforms: an Empirical Analysis”, OECD Economics Department Working Papers, OECD Publishing, forthcoming.

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- *Reducing administrative extensions of collective agreements* increases firms' freedom to set working conditions and wage policies and can increase labour demand, in particular for low-productivity workers and "outsiders" who may otherwise be priced out of the labour market. Empirical evidence confirms this by showing that past reductions in administrative extensions of collective agreements have reduced unemployment, particularly for females.¹⁰ For example, taken at face value, the results suggest that reducing "excess" coverage of collective bargaining (a measure of the degree of administrative extension)¹¹ in Portugal to the level prevailing in Germany – a reduction equivalent to the median reform over the past three decades – might lower female unemployment by almost 0.5 percentage point after three years.

Tax reforms

Economic theory and empirical evidence suggest that shifting the tax burden away from more mobile and elastic bases such as capital and labour can deliver quick and substantial short-term gains. This is especially true for tax cuts targeted at women and low-skilled workers, whose labour supply tends to be more responsive to tax changes.¹² A growth-friendly way to offset the budgetary impact of such cuts is to shift the burden towards taxes on less mobile and responsive bases, such as consumption, immovable property, or the environment,¹³ as often recommended among *Going for Growth* reform priorities (Chapters 1 and 2). New empirical results based on past reform experiences across OECD countries broadly confirm this prior:

- *Reducing the share of direct taxes in overall tax revenue* appears to quickly reduce unemployment, particularly for young people. In the short run, such reforms also trigger stronger labour force participation by female and young people, although these effects are eventually found to fade away after three years. Moreover, private investment growth appears to rise in the wake of such tax reforms. This is consistent with the view that shifting the tax burden away from labour and capital makes the tax structure more investment-friendly.
- *Reducing the labour tax wedge* (i.e. the difference between the salary costs of a single "average worker" to the employer and the net income the worker receives)¹⁴ is found to raise senior employment in the short run, driven by increased participation. However, there seems to be no effect on aggregate employment, perhaps suggesting that it takes a longer time to materialise.

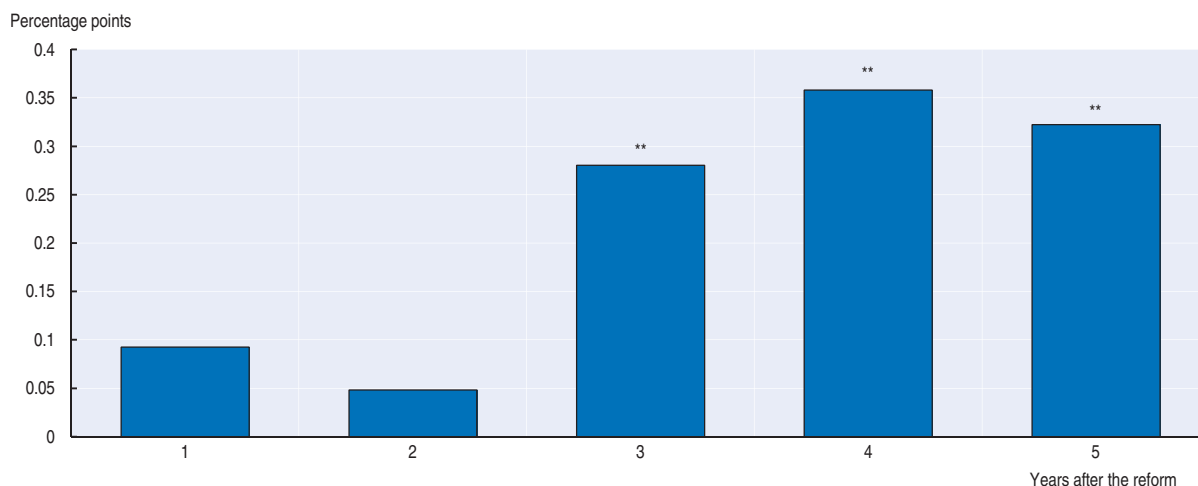
Product market reforms

Product market reforms are advocated to boost long-run labour productivity and labour utilisation; empirical evidence of their beneficial effects is abundant.¹⁵ Short-run effects are less straightforward to predict and are likely to depend on the nature of the reform, whether it applies to economy-wide regulation or is sector-specific and (in the latter case) on the sector that is subject to reform. For instance, product market reforms can entail transitory costs in terms of job losses (Cacciatore *et al.*, 2012). Such transitory costs are likely to arise especially in the aftermath of liberalisation of mature industries with limited growth potential and large incumbents, e.g. postal services in a number of high-income OECD countries.

The new empirical analysis finds that product market liberalisation of network industries¹⁶ reduced investment and GDP growth in the near term, possibly reflecting capital spending cuts in the wake of past privatisation episodes.¹⁷ At the same time, such

reforms are found to have boosted labour force participation in the medium term (Figure 4.5), especially for women. Product market reforms are also more likely to boost short-run employment when they lift supply constraints in sectors where there is pent-up demand, such as the removal of entry barriers for new firms in retail trade and professional services. In particular, country-specific evidence strongly suggests that product market reforms that make it easier to create a firm and recruit workers in retail trade bring relatively quick employment gains (see *e.g.* Bertrand and Kramarz, 2002, for evidence from France).

Figure 4.5. Product markets reforms typically encourage labour force participation
Change in aggregate labour force participation following a "typical" product market reform



Note: ** represents statistical significance at the 5% level. The simulation is based on the median-sized reform observed in the estimation sample.

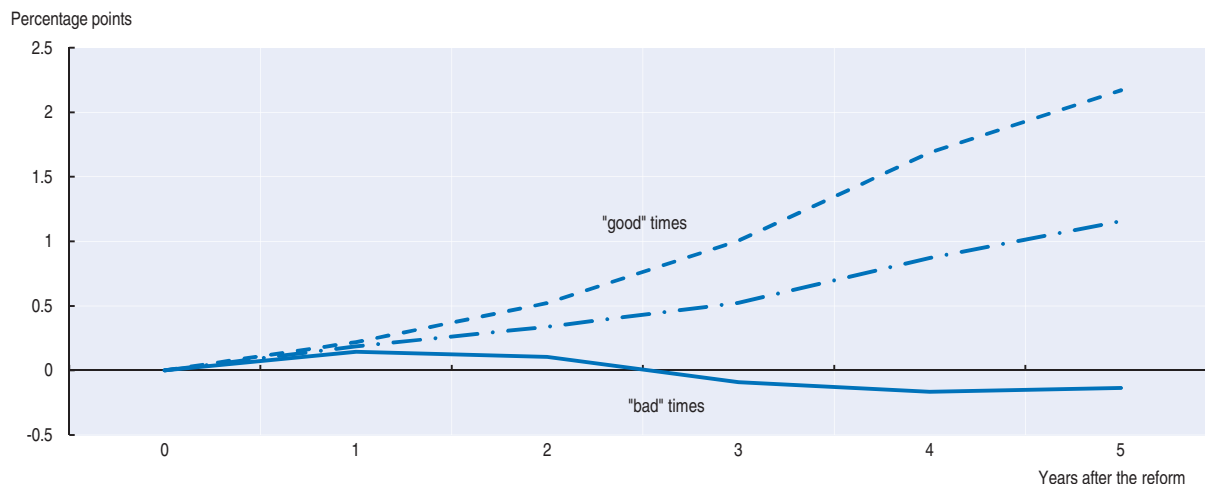
Source: Bouis, R. et al. (2012), "The Short-term Effects of Structural Reforms: an Empirical Analysis", OECD Economics Department Working Papers, OECD Publishing, forthcoming.

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The role of macroeconomic conditions


So far, this empirical section has presented the average short-term impact of past reforms. However, this impact may vary depending *inter alia* on prevailing macroeconomic conditions. Indeed, the short-term positive effects of unemployment benefit and job protection reforms turn out to be stronger during "good" times, and weaker – and in some cases even negative – during "bad" times. For example, the analysis suggests that a "typical" reduction in the initial unemployment benefit replacement rate would bring about a 0.5 percentage point employment gain after three years in "normal" times – *i.e.* when there is no slack in the economy, as indicated by a zero unemployment gap – but the same reform could lead to employment losses in very depressed labour markets (Figure 4.6). This asymmetric effect may reflect the fact that while raising incentives for the unemployed to look harder for a job might increase outflows from unemployment when the labour market is tight, it could be ineffective and even counter-productive when labour demand is particularly weak. Likewise, a "typical" decline in job protection on regular contracts appears to raise employment over the medium term in "good" times, but to reduce it in "bad" times.

Figure 4.6. Unemployment benefit reforms become ineffective when the economy is depressed
 Change in aggregate employment following a “typical” reduction in initial unemployment benefit replacement rate:
 the influence of economic conditions



Note: The lower line corresponds to the impact of the reform during “bad” times, while the upper line represents the impact during “good” times, corresponding to the minimum and maximum levels of the unemployment gap, respectively, as observed across the sample (i.e. across all countries and time). The central broken line represents the impact of the reform when the unemployment gap equals its median value. The unemployment gap is calculated as the difference between the structural rate of unemployment and the observed level of unemployment in the estimation sample.

Source: Bouis, R. et al. (2012), “The Short-term Effects of Structural Reforms: an Empirical Analysis”, OECD Economics Department Working Papers, OECD Publishing, forthcoming.

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Notes

1. This chapter is based on analysis in Bouis et al. (2012) and Cacciatore et al. (2012).
2. The fiscal multiplier measures by how much output or aggregate demand increases (decreases) in response to a given change in the fiscal balance. For a review of the factors that influence the size of fiscal multipliers, see Sutherland et al. (2010).
3. In the absence of credit constraints and under perfect information about the future income gains from reforms, there is no distinction between permanent income and wealth effects.
4. Angeloni et al. (2003); Mishkin (2007).
5. Adjémian et al. (2007).
6. These reforms may still have demand effects if unfinanced, as discussed above.
7. This model-based conclusion needs to be taken with care, though, because it does not incorporate the potential negative short-term effects of reforms arising through increases in precautionary savings. Moreover, the model assumes away the possibility of impaired banks and ill-functioning credit channels.
8. For recent empirical work based on historical episodes of fiscal contractions, see Sutherland et al. (2012) and Chapter 3 of IMF (2010).
9. See de Serres et al. (2012) for a recent assessment and various editions of the *OECD Employment Outlook* (for instance OECD, 2010). This result is consistent with Blanchard and Landier (2002) and Bentolila et al. (2010), who argue that *two-tier reforms of job protection* may in fact increase the equilibrium unemployment rate by increasing unemployment turnover.
10. These results are in line with recent OECD empirical work in de Serres et al. (2012).
11. The “excess coverage” of collective bargaining is taken as a *de facto* measure of the degree of administrative extension, as it is defined as the difference between the percentage of workers who are covered by collective bargaining agreements regardless of whether they belong to a trade union (the union coverage rate) and the percentage of workers belonging to a trade union (the union density rate).

12. See OECD (2011) for recent evidence.
13. See *e.g.* Arnold *et al.* (2011).
14. This measure is based on *National Accounts* and includes consumption taxes.
15. For recent evidence on the productivity effects of product market reforms, see *e.g.* Bourlès *et al.* (2010) and for their (aggregate) employment effects see *e.g.* Alesina *et al.* (2005).
16. The analysis relies on product market regulation reforms in network industries (telecoms, electricity, gas, post, rail, air passenger transport, and road freight). Indeed, data unavailability on a time-series basis makes it impossible to analyse the dynamic impact of economy-wide reforms.
17. However this finding is at odds with other recent OECD empirical analysis (Kerdrain *et al.*, 2010).

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