



# Engine for Growth, Structural Reforms and Monetary Policy: CompNet findings and tools for policy analysis

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# Price competitiveness and external imbalances

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- Elasticity of euro area exports and imports relative to HICs is significant
  - Exchange rate is an important tool to adjust imbalances, but
  - Elasticities differ across euro area countries

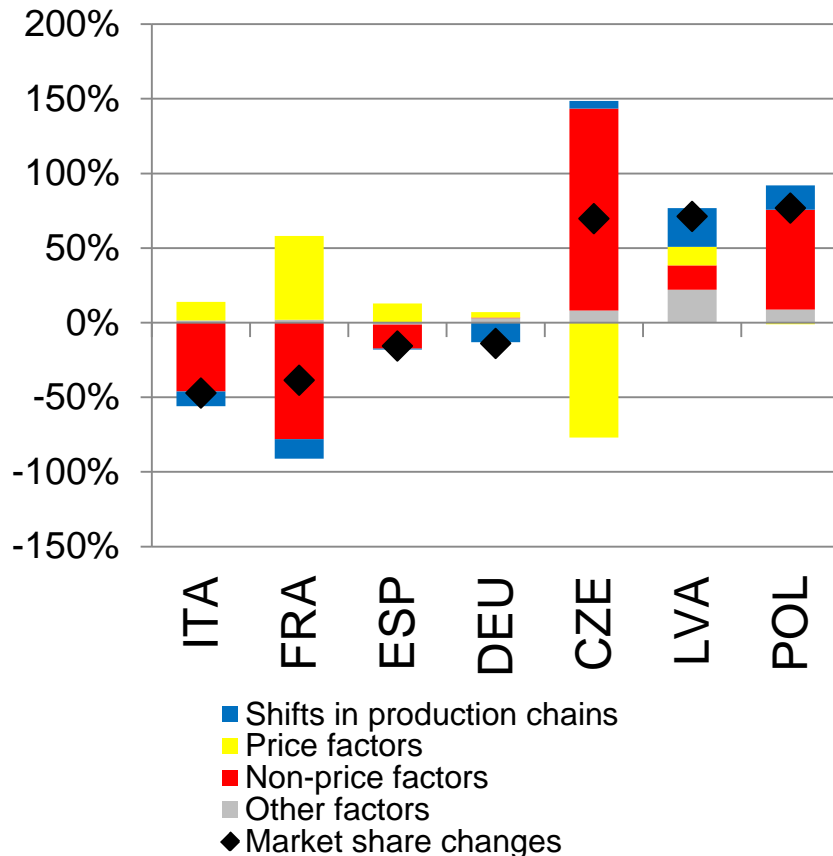
	<i>DE</i>	<i>ES</i>	<i>FR</i>	<i>IT</i>	<i>NL</i>
<i>Long-run elasticity of exports to PPI</i>	<i>-0.30</i>	<i>-0.93</i>	<i>-0.97</i>	<i>-0.55</i>	<i>-0.31</i>

*from Christodoulopoulou and Tkacevs (2014)*

- Firms' heterogeneity plays an important role
  - Least productive firms tend to react more to exchange rate movements (Berthou et al., 2015)

# Non-price competitiveness

Decomposition of changes in global market shares (1996-2011)



- Non-price factors (i.e. relative quality) provide significant contribution to external performance
  - Even after controlling for relative costs, GVCs and other factors
- Also, the product and geographical composition matters
  - Who are you competing with is important (Silgoner et al., 2013)

from Benkovskis and Wörz (2015)

# Firms' heterogeneity and growth

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- A fatter right tail in the firm productivity distribution contributes to stronger growth in TFP, exports and real GDP per capita (*Barba Navaretti et al., 2015; Benkovskis and Bluhm, 2015*)
  - a country's competitive position is strongly driven by the most productive firms
- The most important channel through which structural reforms increase investments and economic growth is lowering of entry barriers to new firms (Aiello et al. 2015)
  - This leads to higher aggregate productivity and higher allocative efficiency
  - more on that in the next slides...

# Why do we always end up talking about structural reforms at the ECB?

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- Is it our business? Yes, for three main reasons (Draghi, 2015; Sintra):
  1. Structural reforms can lift the path of **potential output**
    - Potential growth is well under pre-crisis level, which implies a lower equilibrium interest rate – run into the LZB
  2. Structural reforms can increase wage and price flexibility, i.e. **resilience to shocks**
    - Which is important to achieve real convergence
  3. Demand and supply policies are **complementary**

# Fostering potential growth

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- Potential growth can be lifted by increasing available production resources - capital and labour
- And by improving the efficiency with which they are used in the production process – TFP
  - TFP performance was already lower in the EA than in the US before the crisis
  - In the academic discussion yesterday we saw that one of the reasons behind this underperformance is the **misallocation of resources**

# Resource misallocation

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- This a situation in which available resources are not put to their best use
- To achieve **allocative efficiency**, resources should be reallocated from low to high productive firms
  - Resource reallocation can only be tracked by using firm-level information
  - And here **CompNet** and other micro-based datasets can help greatly policy-makers

# Are resources flowing from low to high productive firms?

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- The short answer from yesterday is, generally yes...
- But with important country and sector differences, related to (Chad's words):
  - "Substitutability" in output markets
  - **Flexibility in input markets**: are more productive firms able to attract more resources? Can more productive firms enter the market and low productive ones exit?



# What market frictions are reducing the flexibility of input markets? (I)

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- Sebnem talked yesterday about **misallocation of capital** in some EA countries being driven by financial frictions + large capital inflows
  - To test for the presence of such frictions, we can explore the correlation between access to credit and the productivity and fixed assets of the firm
  - Possible to do using the “joint distributions” of CompNet
  - Descriptive evidence shows that, in most countries, there is a monotonic negative correlation between access to credit and firm’s TFP
  - But further work is needed

# What market frictions are reducing the flexibility of input markets? (II)

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- We have some more evidence on **labour/product market frictions**
  - Di Mauro and Ronchi (2015) show that firms subject to multi-level collective bargaining are more likely to downsize, independently on their productivity
  - Bartelsman et al. (2015) show that the link between employment creation and productivity is largest in manufacturing, and lowest in construction, ICT and professional services
    - ▶ Partly linked to the relatively higher mark-ups (entry restrictions?)
    - ▶ Looking at within-country developments over time, it has also been found that a reduction of the PMR and EPL indexes over time correlates with more and “better” labour reallocation