

What effects is EMU having on the euro area and its member countries?
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EUROPEAN CENTRAL BANK

Comments on "The Effects of EMU on Structural Reforms in Labour and Product Markets" by Romain Duval and Jorgen Elmeskov

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For the conference "What Effects is EMU having on the Euro Area and its Member Countries?" to be held at the European Central Bank, Frankfurt, 16-17 June 2005.

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The main DE results:

- Structural reforms are more likely to be introduced in small countries (more open economies) than in large countries (less open economies).
- In a large country, structural reforms are more likely to be undertaken if it has an independent monetary policy. So EMU causes a problem.

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Why? In a closed economy with inflation targeting, structural reform

- → rise in potential output
- → negative output gap
- → projected inflation falls below target
- → looser monetary policy
- → output, employment up

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- In a small open economy, falling inflation
→ increasing competitiveness → strong
output and employment response.
Monetary policy is not required.
- In a large open economy, the
competitiveness channel operates too
slowly and monetary policy is required.
So, if not available, incentives for
structural reforms are reduced.

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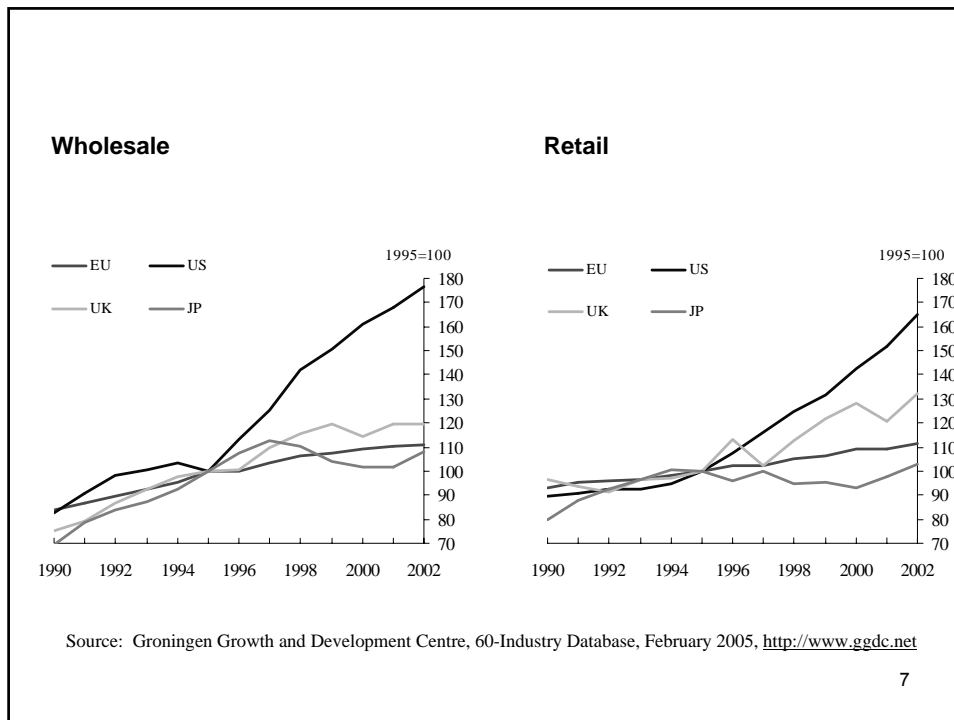
Some ideas on structural reforms

- Product market reforms → increased competition.
- Even in a large open economy, this probably requires less monetary policy to generate an expansion. So the EMU problem is less important.

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- Focus product market reforms on large service sectors, eg. retail distribution, professional and financial services. Why?
- Because they are large
- Less natural (international) competition
- Big productivity gains, for example

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- Also focus on private job placement sector. Why?
- Important for smooth running of labour market
- Enables public job placement service to focus on hard-to-place non-employed

Finally, product market reforms can, in part, be driven by supra-national agencies, unlike labour market reforms.

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- Labour market reforms tough.
- Easy to go in the wrong direction eg. reduce labour supply (early retirement, compulsory hours reduction) makes matters worse, as does only reducing regulations on fixed term as opposed to permanent contracts.

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Why not focus on helping those in a bad situation eg. help non-employed into work?

- Point to good examples eg. Denmark, Netherlands
- Avoid examples which are too “Anglo-Saxon, neo-liberal!”
- Note crucial importance of giving the Civil Servants the right incentives

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Finally DE are to be congratulated on uncovering some really interesting and important results.

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