CompNet The Competitiveness Research Network

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

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Price competitiveness and external imbalances

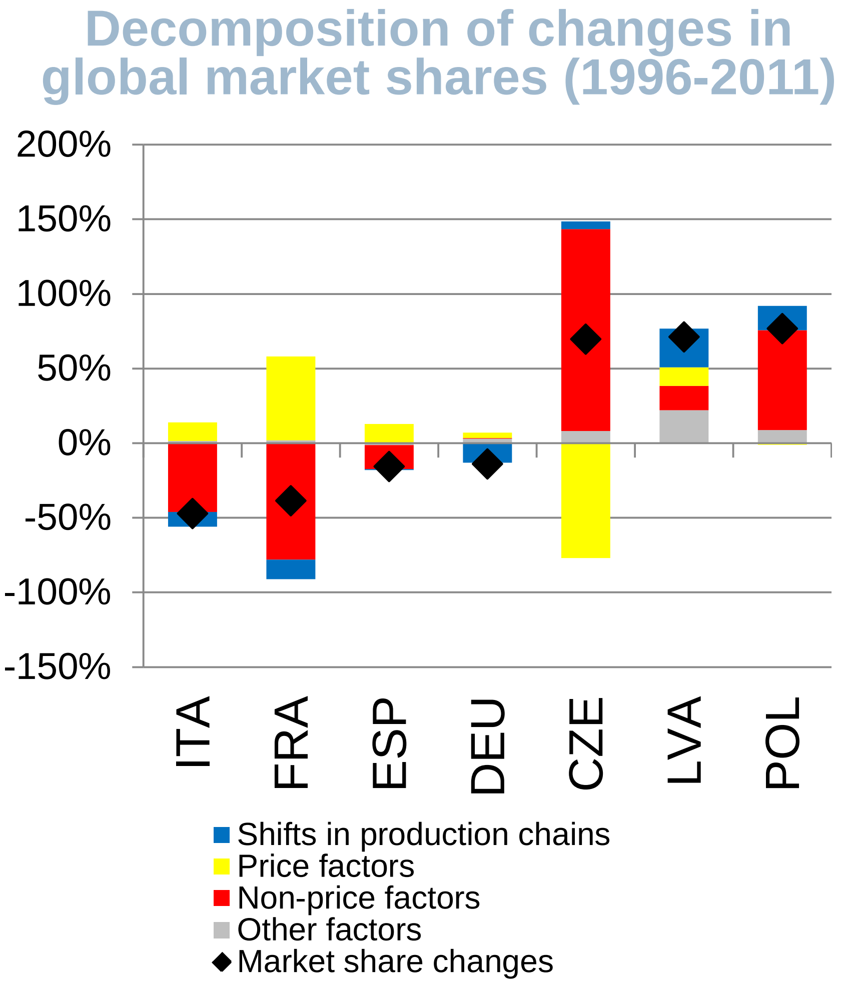
- Elasticity of euro area exports and imports relative to HCIs is significant
  - Exchange rate is an important tool to adjust imbalances, but
  - Elasticities differ across euro area countries

	DE	*ES*	*FR*	*IT*	*NL*
Long-run elasticity of exports to PPI	*-0.30*	*-0.93*	*-0.97*	*-0.55*	*-0.31*

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



from Benkovskis and Wörz (2015)

- 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)

Firms' heterogeneity and growth

- 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?

- 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

- 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

- 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?

- 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)

- 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)

- 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