

Contrasting Europe's Decline: Do Product Market Reforms Help?

by

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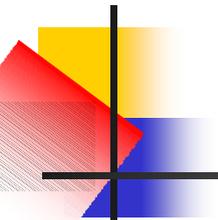
Discussion by Jan Svejnar

for conference on

"Structural Reforms without Prejudice"

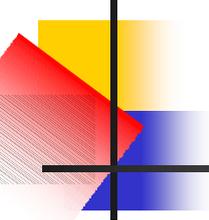
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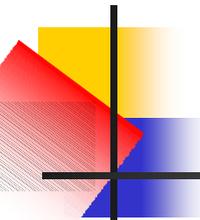
Overall Assessment

- Great report because
 - Interesting and important issues
 - Combines case studies with econometrics
 - Innovative analysis
- Also
 - Data strengths and limitations
 - Controversial aspects of analytical strategy
 - Strong results but with unusual twists



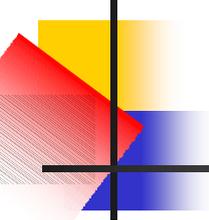
Key Underlying Ideas

- Europe started the 21st century with good macro conditions and high expectations for growth – too optimistic
 - Productivity growth has been stagnant
 - Erosion of Europe's exports market share
 - Increasingly limited ability to attract FDI
 - Can product market reforms boost productivity and other structural changes (e.g., in labor markets)?



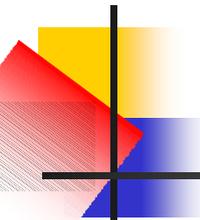
Research Question and Setting

- Are product market reforms related to Europe's poor growth and productivity record?
- Focus on product markets since labor markets have already received attention
- Tertiary sector = the unfinished agenda



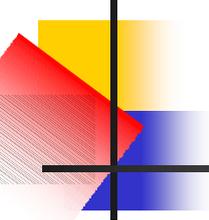
What the Report Does

- Takes stock of reforms in key services
 - Case studies of Germany, Italy and the UK
 - Examines network industries as well as the trade sector and professional services
- Assesses the direct and indirect effects of the tertiary sector on the whole economy



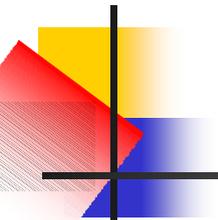
Key Findings

- Deregulation of services leads to productivity growth in the service sector and the economy as a whole
 - Gains not evident in the short run
 - Depends on sector (telecoms vs. rails or water)
 - Services = key inputs for the economy
 - Not very tradeable
 - Rigidities in their supply discourage FDI
 - Key determinant of competitiveness



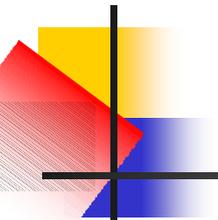
Data

- Substantive case-study information from Germany, Italy and the UK
- Quantitative indicators of service sector regulations (R) and performance (glp and $mner$) for 24 non-service industries
- 1994-99 data on glp and 1997-99 data on $mner$
- Performance = focus



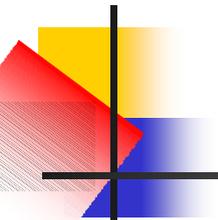
Key Constructed Variables

- Indices of regulation – R
 - **R(NET)** – based on the OECD index of regulation of individual network services and the I-O linkage of a given service sector to a given industry
 - Q1: Why not separate the index of regulation and the weight of a given service in a given industry
 - Q2: What is the OECD index? Why not use its components as explanatory variables directly to get at appropriate policies?



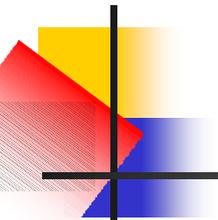
Key Constructed Variables

- Indices of regulation – R
 - **R(BA)** – country dummies (for regulation of business activities) combined with the average I-O linkage of a given service sector to a given industry across the three countries
 - Q: Basically equivalent to including weighted country-specific effects – clever but could be capturing other effects



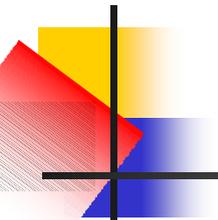
Key Constructed Variables

- Indices of regulation – R
 - **R(NET+BA)** – strictest level of regulation for network industries taken as the level of regulation of business services (similar to R(NET))



Econometric Methodology

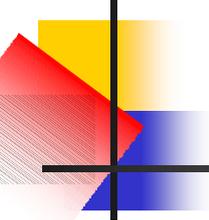
- Simple partial adjustment model with Rs and sectoral (how broad?) fixed effects
- Change in *glp* and in *mner* are dependent variables
- One long-difference observation per industry (a cross section of differences)
- OLS estimation



Econometric Methodology

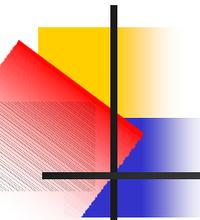
- Issues

- Model is parsimonious – other factors?
- Sectoral dummies (if finely defined) could capture other effects and control for time-invariant endogeneity (selection) issues
- Could increase number of observations by using data from early 1990s and 2000s
- Look at the effects of R on level of *mner*



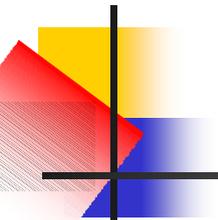
Results

- In the 1990s *glp* and *mner* increased in UK as opposed to Germany and Italy
- $R(NET)$ and $R(NET+BA)$ had negative effects on growth of *glp* and *mner*
 - Support for the hypotheses advanced in the report
 - Consistent with the case study information
 - Other factors?



Overall Assessment and Directions for Future Research

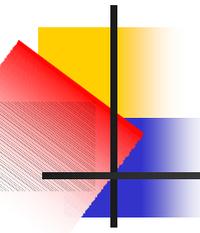
- Important study
 - Provides (tentative) empirical evidence
 - Identifies a key area for policy work
- Possible extensions
 - Re-estimate with more data and fuller model
 - Use the I-O analysis to identify other sectors that have strong forward linkages and where policies could improve efficiency



What Other Factors Keep Europe Behind?

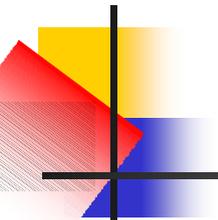
- Ltd. entrepreneurship & venture capital
 - The US
 - Abundant VC during bubble of the 1990s
 - More risk taking => more invention and innovation
 - Europe
 - Less venture capital => less entrepreneurship
 - Stronger tradition of becoming an employee than entrepreneur

What Other Factors Keep Europe Behind?



■ R&D

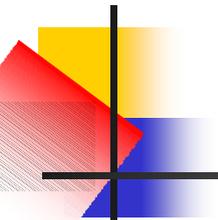
- In some areas (GSM technology) Europe is the leader
- But on average firms in Europe have been doing less research than those in the US and Japan
- Some innovation (e.g., in biotech) restricted by policies
- In other areas (information technology) Europe is behind in production and in use of the sector's products
- Slow transfer of scientific results into applications



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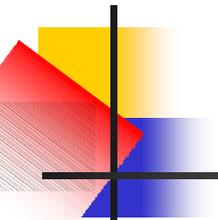
- **Human capital**

- Brain drain to the US
- “Best minds prefer to be bankers rather than scientists”
- Aging of Europe’s population
- Importance of human capital externalities (spillovers)



What Other Factors Keep Europe Behind?

- Leadership and perception of leadership
 - US economic activities lead the rest of the world
 - Long-term economic growth
 - Business cycles
 - Stock markets
 - Why, given that EU is a similar size economy?
 - Some is real leadership (concentration and diffusion of major innovations; single voice; greater homogeneity)
 - Some is perception/expectations



Future Prospects

- The US is at its potential – hard to advance
- Japan acts as if paralyzed
- Europe faces problems, but it has tremendous unexploited possibilities and
 - Largest free trade zone in the world
 - Single currency (and now even constitution)
 - Increasingly able to act as a unified economic power
- Q: Is Europe is ready to realize this potential?