# THE EFFECTS OF STRUCTURAL REFORMS ON OUTPUT AND EMPLOYMENT: A LITERATURE REVIEW

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## 1. INTRODUCTION

Structural reforms are essentially measures that change the fabric of an economy, the institutional and regulatory framework in which businesses and people operate(ECB, 2017). In addition, reforms can effect specific sectors, such as those encouraging innovation and technology. Furthermore, structural reforms ensure that the country is more resistant to shocks(Culiuc and Kyobe, 2017). Recently, declining in productivity has raised interest on effects of structural reforms. As reforms are one of the most important ways of achieving social, economic and technological standards of development and transformation in a country, determining the effect of structural reforms on output and employement in this context is an important step in assessing the success of these reforms. The purpose of this study is determining the effect of structural reforms on output and employement from economy literature perspective in detail.

In this study, the economy literature about structural reforms is examined from different features as type of reform(labour and product market, trade, and institutional frame), type of country(advanced or developing) and branch of economics(micro or macro level).

From types of reform firstly, labour market reforms provide low cost labour market that more resilient to changes and shocks in the economy. Secondly, product market reforms reduce entry barriers in network sectors, increase competiton, and reduce rents in protected firms, and allow cheaper and better goods and services provision(Blanchard and Giavazzi, 2003). Thirdly, trade reforms provide to reduce tariffs in international trade and remove non-tariff barriers. These are the things that effect dispersion of resources fairly between countries, and enhance technology transfers internationally(Alfaro et al., 2009). Lastly, institutional reforms ensure that more strict implementation of contracts and property rights, faster bankruptcy mechanisms, reduction of bureaucracy, and removal of corruption in the public sector. These reforms make firms can adjust capital stocks and forecast for future(Alesina et al, 2005).

The other perspective is the type of country that is subject to structural reforms. This means that reforms vary from advanced to developing countries. Dabla-Norris and Ho and Kyobe(2016), IMF(2015), and Prati et al.(2013) have expressed that structural reforms rely on different country-specific parameters. This shows that advanced and developing countries should regulate structural reforms according to their development stage.

The last perspective is which perspective have been interested by researchers such as micro and macro economics. In macro level, IMF(2016), Adascalitei and Morano (2016), and Duval and Furceri (2017) have found that impact of different types of labour market reforms depend on business cycle conditions. There are so many studies in literature about micro level and mostly they focusing to advanced economies. However, Almeida and Balasundharam(2018) has analysed that whether the effect of structural reforms depend on firm characteristics, such as profitability, leverage, and sector in both advanced and developing countries. They have found that structural reforms' effect on output is larger than on employment. This means that structural reforms raise firm productivity.

Even though the study has tried to inspect versatile, some parts of the study has lack of information about structural reform literature. As a result, structural reforms have commonly appeared to influence positively and too largely and employement of countries' economies in all parts of the study.

## 2. STRUCTURAL REFORMS

Structural reforms is very needed stuff for a country's sustainable economics perspective. According to orthodox economic theory structural reforsms are defined as removal supply-side constraints in an economy. Consequently, structural reforms support efficient factor allocation and contribute medium to long term economic growth. Furthermore, the depth and breadth of a structural reform package are important for this package to be acceptable in terms of economic performance (Marrazzo, M. & Terzi, A., 2017). This explains that well-designed structural reform packages bring the economy more resilient.

When we look at labor market reforms, they have made it easier to adjust wages and employment in response to changing economic conditions. They also reduce long-term and youth unemployment, increase female labour participation, improve the quality of jobs, and encourage investment in skills. Furthermore, they allow workers and firms benefit from the opportunities related to rapid technological progress. In the absence of structural reforms in the labor market, workers may face long-term unemployment and low wages.

Product market reforms enhance competitiveness in sub-sectors of product market. Especially, providing incentives to innovation, and investments in human and physical capital boosts productivity. Structural reforms in the product market provide more efficient regulations, less complex licensing procedures, lower administrative and market entry costs. These regulations encourage the creation of new firms, enable the restructuring of inefficient firms or facilitate their exit from the market. In addition, it enables firms to reach the optimum scale size and contribute to both production and employment.

Financial market reforms could strengten the contribution of finance both to a more efficient allocation of savings. They also increase sharing financial risks across countries. These financial reforms have emerged as banks' strengthening their resources against vulnerabilities by transferring their resources from weak firms to more innovative and dynamic firms and diversifying their assets.

Structural reforms in fiscal side of the economy make public funding more efficient and provide better service to the private sector. Reforms which improve the functioning of tax administrations and distrubution of tax rates fairly based on income-level are the most common fiscal reforms than can be actioned.

It should be kept in mind that structural reforms are country-specific and tailor-made, including social preferences, institutional structures and structural changes. In this context, open access to detailed statistics and other public data is of great importance in realizing structural policies.

Today, economy literature not just study structural reforms from the perspective of output and employement, it also deals with structural reforms from the institutional perspective and good governance. In the light of these informations, the literature review of the effects of structural reforms on output and employment is studied.

Structural reforms include a broad range of measures that, on principle, can handle barrier to an efficient resource allocation. Thereby, structural reforms increase elasticity to respond to changes in economic fundamentals. They also increase productivity in good and service production, employement, investment, so this make a country more resilient to shocks(Culiuc and Kyobe, 2017).

## 3. TYPE OF REFORM

### 3.1. Labour Market Reforms Literature Review

Belot and Ours(2004) have researched why some OECD countries are successfull to lower their unemployement level. They have inspected relationship between unemployement and labor market institution such as labor taxes, unemployement benefits, employement protection, union bargaining power, and decentralization of bargaining. They show that the particular combination of labor market instituons are responsible low unemployement rates. Besides this, if financial incentives increase, it concludes to lower unemployement rates. Lastly, they express that countries can borrow some features from each other to lower their unemployement rates, but this process can not continue with same level in every country since countries' institutional framework are very different from each other.

Adascalitei and Morano (2016) analysed the determinants and impacts of reforms of employement protection legislation, using novel inventory that covers 111 developed and developing countries between 2008 and 2014. As a result, they find that deregulation reduces employement rates in both developed and developing countries in the year after enaction. Deregulation also increases unemployement rates in developed countries in the short-term; but the impact is not statistically significant in developing economies.

IMF (2016) and Gal and Hijzen (2016) have analysed of labor and product market reforms, using micro-data, in advanced economies. Furthermore, IMF(2016) have stated that the effects of labor market reforms were previously found to be procyclical.

The output effect of labour market reforms is dependent on economic activity situation and reform type. Lower labor tax wedges and higher spending on active labor market policies appear to have larger effects on output under weak cyclical conditions(Banerji et al., 2017).

Almeida and Balasundharam(2018), labor market reforms to prevent high labor costs of labor dismissal make labor markets more suitable for economic conditions, and high employment can be achieved in the long run. They have also found that labor market reforms affect output in medium term while they are insignificant in short term. Medium term is from year 2 to year 5. The results of the study have shown that reform's effects on employement is insignificant.

### 3.2. Product Market Reforms Literature Review

Blanchard and Giavazzi(2003) have intended to construct a general equilibrium model with rents and bargaining, and use it to think about the effects of product and labor market deregulation. Starting with product market reforms, they have found that decreasing price of goods results liberalization in product market and increase real wages. The less removing entry barriers in product market express the less unemployement level.

Lanau and Topalova(2016) suggest that product market reforms is important branch of policy to rise potential growth. Product market reforms' short-term and firm level effects are positive and this effect is strengthened over time(Gal and Hijzen, 2016).

According to Banerji et al.(2017), across developed countries, liberalization of retail trade, professional services, and removing barriers to the liberalization of the network sector cause to big raises in GDP. They also say that product market reforms creates a positive output impact in the mid-term under the contidions which are either strong or weak cyclical(IMF, 2016).

### 3.3. Trade reforms Literature Review

Wacziarg and Welch(2008) presents new and strong proof that liberalization dates of countries correspond to characteristic breaks of economic growth, investment and openness. Another study have stated that trade reforms supports higher rates of economic growth, most specifically in Asian countries(Estevadeordal and Taylor, 2013).

According to Christiansen et al.(2013) domestic fiscal reforms and trade reforms are strongly related to economic growth in middle income countries. According to the consensus of Sachs and Warner(1995), Dollar and Kraay(2004) and Wacziarg and Welch(2008), even though the relationship among trade liberalization and economic growth is less openly determined, reducing trade barriers is supportive of growth(Christiansen et al., 2013). Christiansen et al.(2013) also discovers that domestic financial reforms are strongly related to positive growth for up to 6 years after the reforms are applied, consistent with previous researchs.

Marrazzo and Terzi(2017) propose a new use of non-parametric Syntetic Control Method to estimate the effect of 23 wide-reaching structural reform packages(including both real and financial sector measures) over the period 1961-2000 and across 22 country. The results of the study, reforms start to create positive impact on GDP per capita only after five years.

### 3.4. Institutional Reforms Literature Review

The quality of institutions are driving force for private investments and enterprenaurship. The distinction between economic institutions is basic cause of economic development(Acemoglu, Johnson and Robinson, 2005).

Alfaro et al.(2009) have proposed some institutional reforms about finance that affect the growth of an economy. They argued that lacking of development in local financial markets are able to restrict the economy's ability to benefit from potential foreign direct investments spillovers. They found that well-developed countries' financial markets earn clearly from foreign direct investments via total factor productivity. They also referred in their study an important imformation about economic growth that Kose et al.(2006) concluded that macroeconomic literature does not have important effect of financial integration on economic growth, but institutional reforms particularly increasing financial development affect intensively on economic growth.

The purpose of the article which is written by Mawussé(2011) is to examine the effect of institutional reforms on revival of African economies. The researchs through econometric panel data estimation indicate that differences between countries over time in terms of private investment, FDI, domestic credit to private sector, and the growth rate of GDP, are significantly affected by differences in efforts of institutional and economic reforms. Thereby, institutional reforms are substantial for job creation, charming of foreign investors, and growth for African countries.

The purpose of Buterin(2017) article is to investigate the impact of institutional reforms on economic growth, theoretically and empirically, in transition counties(new European Union members) and Croatia, over the period 1996-2012. In order to verify the hypothesis, it is used Arellano-Bond dynamic panel analysis of transition economies and Croatia. The conclusions indicate that there is an important positive effect of institutional reforms on the economic growth of transition countries and Croatia, which constitutes preconditions that are very important for the future growth rate of the Croatian economy.

## 4. TYPE OF COUNTRY

Dabla-Norris et al.(2016) evaluate the role of structural and institutional reforms which drive productivity growth between countries which are at different stages of development using distance-to-frontier framework. They measure whether specific policies and reforms are important to increase efficiency in total and sectoral levels for some developing and developed markets and economies. The results of paper show that the productivity returns depend on where a country is located and reforms suppose to be arranged based on stage of economic development. That said, the payoffs from alternative structural reforms depend on various country-specific factors, including the stage of development (Dabla-Norris, Ho and

Kyobe, 2016; IMF, 2015; and Prati et al., 2013). Because of the heterogeneous impacts, Dejong and Ripoll(2006) discuss that underdeveloped countries should implement different economic policies than the developed ones. Quinn and Toyoda(2008) stated that liberalization in capital account have positive and strong relationship with growth rate for different country groups. For these reasons, the literature studies of developing and developed countries related to structural reforms is examined separately.

### 4.1. Developing Countries Literature Review

MacKinnon(1973) and Shaw(1973) argue that financial repression prevent the efficient capital sharing and increase financial development and economic growth by combining local capital markets through financial liberalization in developing countries.

Dejong and Ripoll(2006) argue that poor countries have more adventageous than rich countries in higher trade barriers. According to their results, a 10% point increase in tariff rates cause 1.3% point rise in per capita growth rate in low income countries. This rate performs 1.6% decrease in per capita growth rate in high income countries.

Billmeier and Nannicini(2013) show that liberalization increase more per capita growth rate of most countries over the period 1963-2000 by using Wacziarg and Welch(2003,2008) binary indicator. Neverthless, most of African countries, which implemented liberalization policies in the 1990s, could not make use of these reforms.

In his article which examines relationship between international trade, capital account, and domestic financial reform and real GDP per capita in the short and long run, Aksoy(2018) discovers that there are a positive relationship among reforms and real GDP per capita in the long run. He also finds that there is an important heterogeneity between countries which means that countries which have better property rights and better contract enforcement benefit from effect of reforms in already in the short run.

Kouame(2018) inspects effects of structural reforms on firm-level productivity for 37 country over the period 2006-2014 in his article. He highlights the results that structural reforms like financial, fiscal, real sector, and trade reforms are significantly increase firm-level productivity.

### 4.2. Developed Countries Literature Review

Spilimbergo et al.(2009) discover that real sector and financial reforms boost income growth both developed and developing countries. These reforms can be counted as domestic financial liberalization, liberalization, and agricultural liberalization.

Adascalitei and Morano(2016)'s analysis find that reforms are mostly directed towards relaxing labour regulations in developed economies and reforms are mostly implemented due to high unemployment rates and low GDP. They also examine short-term effects of reforms on labour market. In developed countries, results show that relaxed existing levels of workers' protection experiences a temporary increase in the unemployement rate. This affects GDP towards lower levels.

## 5. BRANCH OF ECONOMICS

### 5.1. Microeconomic Structural Reforms Literature Review

The development in legal system quality is a reducing factor for idiosyncratic risks which firms owners faces. Moreover, this condition provide to increase firm size(Laeven and Woodruff, 2007).

Henrekson and Johansson (2010)'s results suggest that less stringent labor market institutions increase aggregate productivity by reallocating labor to more productive firms and through firm entry and exit.

In their article, Henrekson and Johansson(2010) propose that less tight labor market institutions rise aggregate productivity by redistributing labor to more productive firms and through firm entry and exit.

Almeida and Balasundharam(2018) discovers that structural reforms have a positive effect on output and employment in the mid-term, parallel to previous researchs.  Moreover, the article also evaluates firm-spesific charachteristics, like size, leverage, profitability, and sector as micro analysis. It is also found that firm characteristics affect the efficiency of structural reforms in the paper.

### 5.2. Macroeconomic Structural Reforms Literature Review

According to Everaert and Schule(2008), they runned a simulation which is set to European Union by IMF which is called Global Economy Model. As conclusion, they find that there are quite big long-term winnings in output and employement from increasing competition in product and labour markets.

Cacciatore et. al(2012) determine that their paper that reforms seem  to induce GDP in short run, but some of the reforms like job protection reforms are considered to rise unemployement temporarily. They also state that product market reforms reduce price increases and rise real wages and fastly induce output and employement generally.

Papageorgiou and Vourvachaki (2017) examined the impact of product and labor market structural reforms for the Greek economy by using the general equilibrium model. The paper demonstrates that while the structural reforms have increased the costs by fiscal tightening in the short term, it shows GDP gains in the long run.

## 6. CONCLUSION

This paper assesses the effects of structural reforms on output and employement as literature review in detail. It examines structural reforms according to type of reforms, type of country and branch of reforms. In the reform type part of the study, product market reforms, labor market reforms, trade market reforms and institutional reforms are assessed. In the country type part of the study, developing and developed countries are examined. In the branch of economy part of the study, the study are evaluated micro and macro level of economics. Although the study has tried to examine the structural reforms in a multi-faceted way, some aspects stay incomplete. For example, the study does not examine structural reforms as a literature review in the short, medium and long term distinctions. In addition, the study focuses on the effects of structural reforms on output and employment, rather than on methodology and data used in the literature review based on type of reform, type of country, and branch of economy. As conclusion, for all parts of the study, structural reforms have mostly seemed to affect positively and largerly to output and employement of countries' economies.

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