Europe Continues to Lag on Structural Reform

Jacob Funk Kirkegaard discusses the reasons why the drive for labor market and other structural reforms in Europe has stalled because of opposition from special interests.


Steve Weisman: The European economy continues to stagnate several years after the financial crisis began in 2010. Europe confronts a debate about the policy mix of how to get out of the slump. Jacob Kirkegaard of the Peterson Institute for International Economics is here with me, Steve Weisman, to discuss the policy mix that faces Europe. Thank you, Jacob. What are the three elements of the policy mix that are being considered?

Jacob Kirkegaard: The classical macroeconomic components are monetary policy, or basically the activities of the central bank. It's fiscal policy, meaning government budgets. And then it's structural reforms of various economies in the euro-area-- or basically the idea that governments change the rules for how the economy operates.

Steve Weisman: You mentioned that ironically the structural reform piece has more unanimous popular support. Yet it doesn't seem to be happening. Why?

Jacob Kirkegaard: It is indeed ironic. Some people think you should have more monetary stimulus, some people think you should have more fiscal stimulus, but there are also people who say the opposite. The one thing that everyone agrees on is that Europe needs to do more structural reforms. They basically need to make their economies more flexible, more competitive and more sustainable and conducive to economic growth.

Steve Weisman: What kind of rules are we talking about that need to be changed—labor regulations, other kinds of commercial regulations?

Jacob Kirkegaard: Certainly, in many euro area countries the problems reside overwhelmingly in the labor market. But labor markets can malfunction in different ways. In some countries they discriminate against the young people. In other countries it's the ability of people to retire too early. In some countries the issue has to do with duality in the labor markets; that there are some workers in some sectors that are very heavily protected and very difficult to hire and fire, whereas other workers—young people—either work on much lower wages and are much easier to hire and fire.

Steve Weisman: Ironically, if it's hard to fire people then employers are reluctant to hire them.

Jacob Kirkegaard: Yes. It's basically a risk calculus from the perspective of the employer. If you believe that your business is going to do well in the coming years you want to expand, you want to hire more workers, but if you know that if you hire more workers that you may not be able to fire them again for several years, the potential financial downside is simply too high.

Steve Weisman: Now the leaders of Italy and France have proclaimed the need for these structural reforms and labor reforms, but there are vested interest that are blocking their path.

Jacob Kirkegaard: Basically, the issue of structural reform is that there's always vested interest involved. And typically, at least what we've seen in the recent years in the euro area, is that you need a big
crisis to overcome these vested interests. That’s what’s has happened in Greece, in Portugal, in Spain and all the other countries that go through an IMF [International Monetary Fund] or Troika [IMF, ECB, EU] reform program.

Steve Weisman: So those countries have done better on this area?

Jacob Kirkegaard: They’ve certainly done better on these issues of structural reforms, partly because they had more to do. They had a less optimally functioning economy before but they have done it because they have no choice. The problem, therefore, is the bigger euro area countries, such as Italy, such as France.

Steve Weisman: Let’s talk about France. You’ve said there’s almost like a structural problem politically in France.

Jacob Kirkegaard: Yes, the problem that countries like Italy and France face is that they don’t have the sort of sword of Damocles hanging over their head from financial markets. That isn’t what is going to propel the political system to overrule special interests. They therefore need a political system that instead can generate a degree of bipartisanship, you would say like in the United States, but basically collaboration between the center right and the center left in these countries, because there are going to be special interests, there are going to be people on the far right or on the far left in every country that don’t want it. So you need to have a political system that generates the ability of people in the center to pass, shall we say, common sense structural reforms.

Steve Weisman: Germany did exactly that and that’s one of the reasons why the German economy has performed relevantly better.

Jacob Kirkegaard: Yes. Germany has certainly had the dumb luck, if you like, of being able to reform structurally its welfare state long before the financial crisis hit. But more importantly, today Germany has a grand coalition between the social democrats and the main center right party of Angela Merkel. But this isn’t the only country. You see this in many European countries that have these grand coalitions. You have it in Austria, you have it in the Netherlands, you have it arguably even in Italy, you have it in most of the Scandinavian countries as well de facto because there’s really no difference between the center right and the center left.

The problem particularly, in my opinion, in France is that they have a presidential system and that being elected president is really the main criteria of success politically in France. That means that you will always have the main political fight in France between the center right and the center left about who wins the next presidential election. And that means that getting this sort of impetus behind collaboration between these forces always tends to fail because they’re always focused on who will be the next president. Which right now, for instance, means that it’s inconceivable, in my opinion, that the mainstream center right of the UMP [Union for Popular Movement] party in France is going to help [President] Francois Hollande’s socialists pass much needed reforms in France simply because they are all focused on making Francois Hollande as weak as possible ahead of the election. The next presidential election in France is 2017 and this is a very destructive political dynamic, which of course we here in Washington know very well.

Steve Weisman: I was about to say that Americans will be familiar with this situation. Thank you very much Jacob.

Jacob Kirkegaard: My pleasure.