Summary for non-specialists
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Structural reforms at the zero bound

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The paper analyses the impact of structural policies at the zero lower bound on nominal interest rates based on the recent academic literature and simulations with the European Commission's QUEST model, with a particular focus on potential negative short-term effects on economic activity.

The model simulations show that the binding zero bound reduces short- and medium-term gains from structural reforms compared to a situation in which monetary policy responds with expansionary interest rate reduction to absorb the increase in potential output. Reforms leading to significant downward price adjustment can, indeed, have negative short-term effects on economic activity as consequence of rising real interest rate in the absence of monetary accommodation. The negative short-term impact is small and limited to the first year, however. Small-scale economic models that suggest larger and more prolonged contractionary effects exclude of mitigating channels, such as the impact of reforms on investment profitability, on the disposable income of households, and on trade competitiveness. Non-standard measures of monetary policy and positive confidence effects from reforms, which are not included in the model-based analysis, may furthermore mitigate negative demand and output effects by reducing the spread between policy rates and lending rates as well as by improving credit availability.

Beyond the practical problem of credible pre-commitment, the QUEST results do not support the idea that postponing reforms to post-ZLB periods is better than current implementation at the ZLB when assessed in terms of economic activity. Transmission channels that mitigate the costs of reforms at the zero bound, such as the impact of reforms on real disposable income and trade competitiveness, also reduce the role of the expansionary anticipation effect associated with future reforms and future income gains.