Vítor Constâncio: 2012 Bernácer prize award ceremony in honour of Nicholas Bloom

Speech by Mr Vítor Constâncio, Vice-President of the European Central Bank, on the occasion of the Awarding Ceremony of the Germán Bernácer Prize for Promoting Economic Research in Europe to Nicholas Bloom, Madrid, 24 September 2013.

* * *

I wish to thank Marie Hoerova for the help in preparing this text.

Ladies and Gentlemen,

It is a pleasure for me to be part of this session to award the 2012 Germán Bernácer Prize to Nicholas Bloom, Professor of Economics at Stanford University. Nicholas Bloom has made influential contributions to the academic debate in two broad areas, both of which are of great relevance for central bank policy-makers. First, his research on the effects of policy and economic uncertainty on business cycles helped us understand better some of the key contributing factors to the protracted slump in output during what has become known as the Great Recession. Second, his research on the determinants of good management practices at the firm level provided important insights on how to support long-term economic growth and competitiveness, including in the European context.

The financial and economic crisis that started in the summer of 2007 brought about unprecedented challenges for central bank policy-makers. Some well-accepted paradigms and widely used models have come to be questioned. It is of course the fact of life that central bankers operate in an ever-changing and, to use one of the keywords from Professor Bloom's research, uncertain world. It is thus an important responsibility of a central bank to ensure that relevant new insights from academic research find their way into the actual conduct of monetary policy. The Eurosystem attempts to cope with this responsibility by fostering a constant intellectual exchange with the research community. The ECB organises great many seminars, conferences and workshops where the most recent research findings can be discussed, and invites leading scholars to visit and conduct research in the ECB, for example by means of the Wim Duisenberg Fellowship. Moreover, the ECB supports promising young researchers by funding five Lamfalussy Fellowships each year. The aim is to promote policy-relevant research that meets the highest academic standards. The ECB also leads and co-ordinates research efforts through Eurosystem research networks to obtain research output which is necessary for ECB decision-making but which is as of yet unavailable at universities or other research institutes. I will come back to activities of one such research network at the end of my remarks.

Research by Nicholas Bloom analysing the effects of uncertainty shocks on the economy is a prime example of a policy-relevant research output. Published in Econometrica in 2009, it could not be more timely.[1] The unprecedented level of uncertainty has been one of the key distinguishing features of the Great Recession. Economic uncertainty refers to an environment in which little or nothing is known about the future state of the economy. There is a variety of sources of economic uncertainty, ranging from wars, acts of terrorism and natural disasters to changes in economic and financial policies. Professor Bloom highlighted the adverse effects of heightened uncertainty on economic activity. Uncertainty leads firms to cut back or defer hiring and investment decisions. It also drives consumers to put off buying new goods. As a result, uncertainty can escalate financial stress and recession, as well as

[1] Nicholas Bloom, 2009, "The impact of uncertainty shocks", Econometrica 77(3), pp. 623–685.

stall labour market recovery.[2] What was new was the attempt to measure general and event uncertainty through a variety of indicators, avoid the trap of reverse causation with the economic fluctuations it was trying to explain and insert the variable in a DSGE model.

Professor Bloom's work on uncertainty inspired further research on the effects of uncertainty, including on the links between uncertainty and monetary policy.[3] For example, the idea that changes in uncertainty may interact with monetary conditions and can drive global financial cycles was one of the themes in this year's Jackson Hole Economic Policy Symposium, the annual gathering of prominent central bankers, finance ministers, leading academics and financial market players from around the world.[4]

Because of its latent nature, uncertainty is difficult to quantify and has to be measured indirectly using a variety of indicators. Here, too, Nicholas Bloom, together with Scott Baker of Stanford University and Steven Davis of the University of Chicago, made an important contribution in developing an economic policy uncertainty index for the US, Europe and other major economies. The measure has been used not only in academic papers but also by investors and financial professionals.[5] It has also been subject to intense discussions in the blogosphere in view of some of its political uses. The difficulties in finding good indicators controlled to avoid reverse causation and the use of political events provided fodder for the debates. Professor Bloom's work on measuring uncertainty stimulated more systematic analysis of uncertainty indices also at the ECB. We developed our own composite uncertainty indicator which combines four components: systemic stress, uncertainty of private households and firms, political uncertainty and financial risk aversion.

Measurement difficulties were also an issue Professor Bloom had to tackle in the second strand of his research, namely in his research on the role of management practices in driving productivity and growth differentials across companies and across countries. Due to an absence of good quality data on management practices, little prior research was conducted on this important topic. To address this gap in the literature, Nicholas Bloom, together with John Van Reenen of the London School of Economics, developed a methodology for quantifying management practices. They carried out a large research project which used a new survey approach to measure management practices in a systematic way in more than 4,000 manufacturing firms across Europe, the US and Asia. The aspects of management practices their approach focuses on are systematic performance monitoring, setting appropriate targets, and providing incentives for good performance. They showed that firms with better management practices are larger, more productive, grow faster, and have higher survival rates. A conservative estimate indicates that differences in management practices

---

2 See Nicholas Bloom, 2011, "The uncertainty shock from the debt disaster will cause a double-dip recession", VoxEU.org, 22 August; and Scott Baker, Nicholas Bloom and Steven J. Davis, 2012, "The Rocky Balboa recovery", VoxEU.org, 20 June.

3 There is a vast body of literature that builds on Nicholas Bloom's uncertainty research. I will only name a few papers which involved ECB researchers. Using German data, Popescu and Smets find that uncertainty shocks are less important drivers of business cycles compared to financial risk aversion shocks; see Adina Popescu and Frank Smets, 2009, "Uncertainty, risk-taking and the business cycle in Germany", CESifo Economic Studies 56(4), 596–626. Bekaert et al. document that a lax monetary policy in the US decreases both risk aversion and uncertainty, with the former effect being stronger; see Geert Bekaert, Marie Hoerova and Marco Lo Duca, 2013, "Risk, Uncertainty and Monetary Policy", Journal of Monetary Economics, 60(7).

4 See Hélène Rey, 2013, "Dilemma not trilemma: The global financial cycle and monetary policy independence", paper presented at the Jackson Hole Economic Policy Symposium. Incidentally, Hélène Rey was the 2006 Germán Bernácer Prize winner.

5 For more details on the construction of the measure see Scott Baker, Nicholas Bloom and Steven J. Davis, 2012, "Measuring economic policy uncertainty", working paper, Stanford University.

account for a significant proportion (10–30%) of the differences in productivity between firms and between countries.[6]

Their research did not stop at documenting the impact of the differences in management practices. They also offered suggestions for policy interventions that could encourage the uptake of good management behaviour. Competitive and flexible markets enable managers to re-optimise resources within and outside the firm more easily. Educational standards matter as well. Better-managed firms have better educated workers and they use them more efficiently. Moreover, better educated managers have necessary skills to adopt state-of-the-art management practices and adapt to changing environment. This enables them to maintain and improve their global competitive position. Multinational companies also have a strong positive effect, as they transplant their management styles to the countries in which they operate.[7]

These research-based conclusions highlight a key role of structural reforms in the wake of the global economic crisis. Countries with more competitive market conditions, better education and more investment in R&D and innovation policies can maximise the beneficial impact of managerial capital on productivity and growth. From the policy perspective, competitiveness issues have been identified as one of the root causes of the economic crisis in Europe and have therefore been explicitly included in the surveillance processes established at EU/euro area and G20 level. To further advance research in this area, the Eurosystem established the Competitiveness Research Network (CompNet) at the end of 2011. The network's objective is to develop a more consistent analytical framework for assessing competitiveness, one which allows for a better correspondence between determinants and outcomes. To do so, the network functions as a unique forum in which different approaches and measures of competitiveness can be discussed, researched and developed, and eventually reconciled. Developing a framework which includes a complementary use of micro and macro data can lead to improved analyses of competitiveness issues.[8]

I am confident that Nicholas Bloom will continue making extraordinary contributions to this and other research areas in the coming years. I herewith extend my sincerest congratulations to you – Nicholas – for winning the 2012 Bernácer Prize.

---

6 See Nicholas Bloom and John Van Reenen, 2007, "Measuring and explaining management practices across firms and countries", Quarterly Journal of Economics, 122(4), pp. 1341–1408; and Nicholas Bloom and John Van Reenen, 2010, "Why do management practices differ across firms and countries?" Journal of Economic Perspectives, 24(1), pp. 203–224.

7 In a recent contribution, Nicholas Bloom and co-authors showed that US multinationals obtained higher productivity from IT than non-US multinationals and that establishments taken over by US multinationals (but not by non-US multinationals) increased the productivity of their IT. They attributed a bulk of productivity differences to differing people management practices across US and non-US firms. See Nicholas Bloom, Raffaella Sadun and John Van Reenen, 2012, "Americans do I.T. better: US multinationals and the productivity miracle". American Economic Review 102(1), pp. 167–201.

8 For more information about the Network visit http://www.ecb.europa.eu/home/html/researcher_compnet.en.html.