

Structural Reforms in DSGE Model

2021-02-08

WP 21/2/08

Central Bank of Armenia
Working Paper 21/2/08

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February 2021

This paper develops a DSGE model for a small open economy dividing it into tradable and non-tradable sectors in order to evaluate the impact of structural reforms on the economy for developing countries. The model is constructed and solved in a way that the steady state level of each sector's employment rate is a function of its sector subsidy level. The economic meaning of such a result is that when a government subsidizes one of the sectors can become over employed. We also discuss the effects of exchange rate depreciation as an unconventional monetary policy tool when there is a ZLB problem or as a tool to boost the economy and to improve the current account.

The results show that directly subsidizing the tradable sector can be a better policy than the depreciation of nominal exchange rate for making the economy more export oriented. The reason of such outcomes is the price stickiness of the sectors, which was validated by checking the sensitivity of the model with respect to its structural parameters. To conclude, for closing current account deficit or simply, for improving it the government should implement policies aimed at changing the structure of the economy.

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