

Structural Reforms in Spain

What has been done? What has been the impact?

Ramon Xifré

ESCI – Universitat Pompeu Fabra

Public-Private Sector Research Center, IESE

Bruegel, November 2, 2015

Goals and outline

1. Presentation of the main economic policy reforms adopted in Spain since 2012. Based on the SpanishReforms project.
2. Examination of the impact of the reforms in selected areas. Did the reforms generate the economic recovery in Spain?
 - a. Correction of external imbalances,
 - b. Developments in the labour market,
 - c. A word about internal devaluation.
3. Looking ahead: Will the recovery last? Pending issues and policy challenges.

Reforms adopted in Spain since 2012

- Only two bold, effectively structural, reforms have been adopted:
 - Labour Market Reform
 - Financial System Reform
- **Labour market** included changes in collective bargaining, internal flexibility, reduction of severance pay. The goal was to reduce duality, wage indexation and youth unemployment. However, this was coupled with expanding (rather than reducing) the menu of labour contracts.
- **Financial reform** (via MoU) included a sequence of legal reforms to transform regional savings banks into banks (improved management, reduction in capacity) and creation of the bad bank for real estate assets.
- Not a structural reform, but **public finances** are more or less in order.
- Advances in these dimensions, together with BCE's QE and a more pragmatic EC approach on deficits, have smoothed markets and improved confidence.
- In the other policy fronts (education, public administration, pensions, competition policy, innovation and R&D), reform **progress has been uneven** and, in certain areas, even reversed.

The Spanish Economy Reform Monitor, 2015-Q2

Assessing current economic performance and monitoring policy reform in Spain

Reported scores correspond to the average of the expert panel

All scores are in the scale 0 (bad) - 10 (good)

	Spanish Government economic policy	
	GOALS	PROGRESS
1. GROWTH AND COMPETITIVENESS	4,2 =	3,2 =
1.1 R+D and the knowledge society	3,1 =	2,4 ▲
1.2 Internationalization	4,9 ▼	3,8 ▼
1.3 Entrepreneurship	4,6 ▼	3,4 =
1.4 Education	4,2 ▲	3,3 =
2. COMPETITION AND REGULATION	4,2 =	3,0 =
2.1 Competition enforcement	4,2 =	3,1 =
2.2 Regulation of product and service markets	4,3 =	3,2 ▼
2.3 Red tape and business environment regulation	4,5 =	3,1 =
2.4 Professional services	4,0 ▼	2,8 =
3. LABOR MARKET	4,4 ▲	3,5 ▲
3.1 Labor market regulations	5,4 ▲	4,2 =
3.2 Active labor market policies	3,4 ▲	2,8 ▲
4. FINANCIAL SYSTEM	6,2 ▲	6,0 ▲
4.1 Recapitalization and restructuring	6,9 =	6,8 ▲
4.2 Other financial measures*	5,5 ▲	5,1 ▲
5. FISCAL POLICY AND PUBLIC ADMINISTRATION	4,5 =	3,7 =
5.1 Economic governance**	5,1 ▲	4,2 ▲
5.2 Fiscal consolidation and fiscal reform	4,9 ▼	4,3 ▼
5.3 Reform of the Public Administration	3,5 =	2,5 ▼
6. WELFARE STATE	4,7 =	4,0 =
6.1 Social Security and pensions	6,2 =	5,5 =
6.2 Health system	4,5 ▲	3,7 =
6.3 Other welfare state reforms ***	3,5 =	2,9 ▲

More info in

www.SpanishReforms.com

“Export miracle” and correction of imbalances

Well-known facts

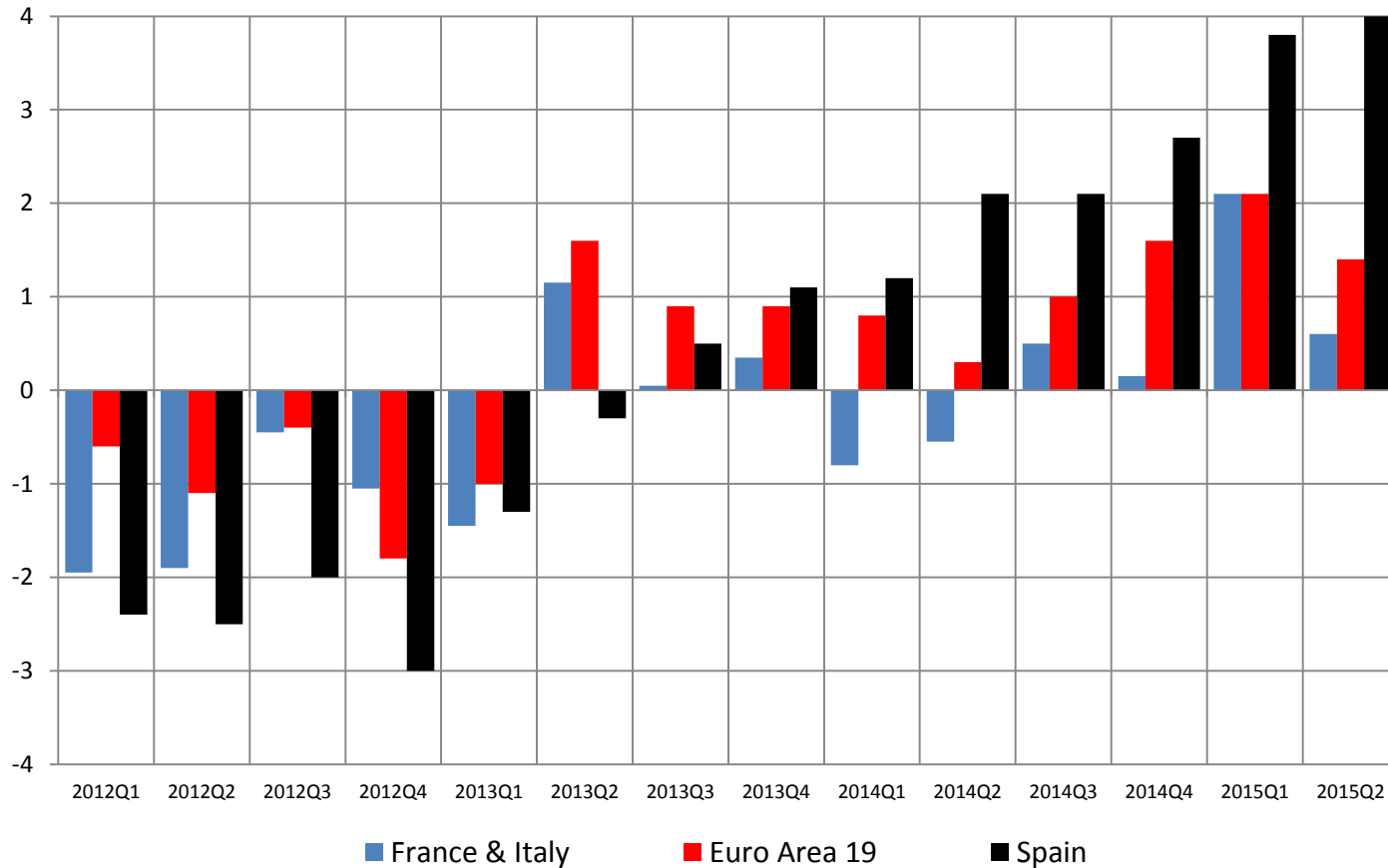
- Spanish correction of the current account deficit is one of the quickest and strongest in advanced economies on record
- Spanish export growth only matched by that of Germany

Complementary evidence

- Commercial surplus is entirely due to services (tourism); net exports of goods are improving but still negative
- Net exports of goods are negative because of (a) net imports of energy product (circa 3% of GDP) as in most countries, but also (b) still very weak (and not at all secured) positive net balance of non-energy products: 0.5% of GDP in Spain vs. 5% in Italy or 10% in the Netherlands
- Spanish exports are extremely concentrated in very few companies. Exports, like R&D, are always concentrated but the magnitude in Spain is extreme. Large exporters tend to cope with laws and regulations better than the rest of firms. This raises the question of the real pro-competitive effects of domestic policy reforms.

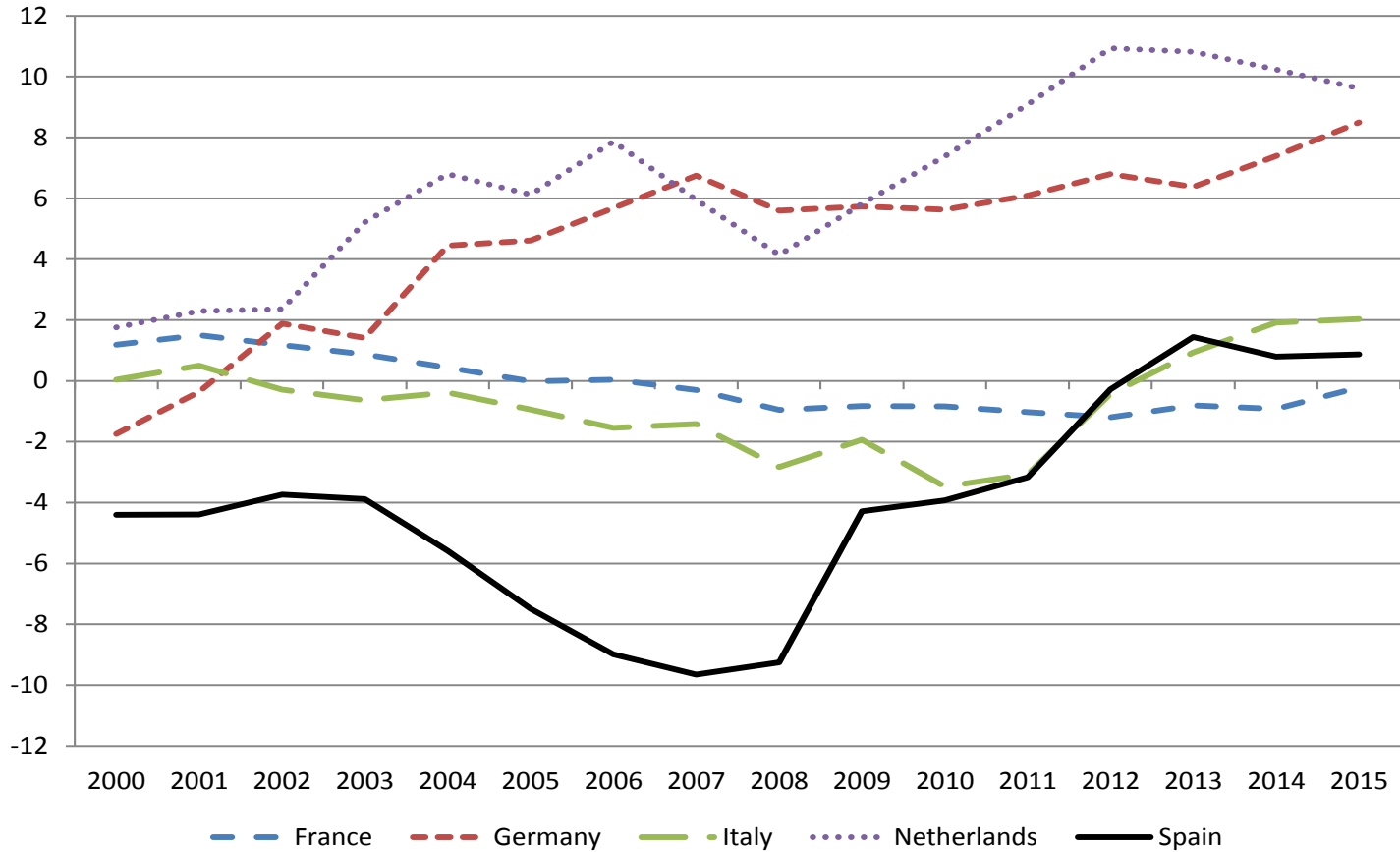
GDP growth. QoQ annualized percentage change

Eurostat. Seasonally adjusted data



Current Account balance as % of GDP

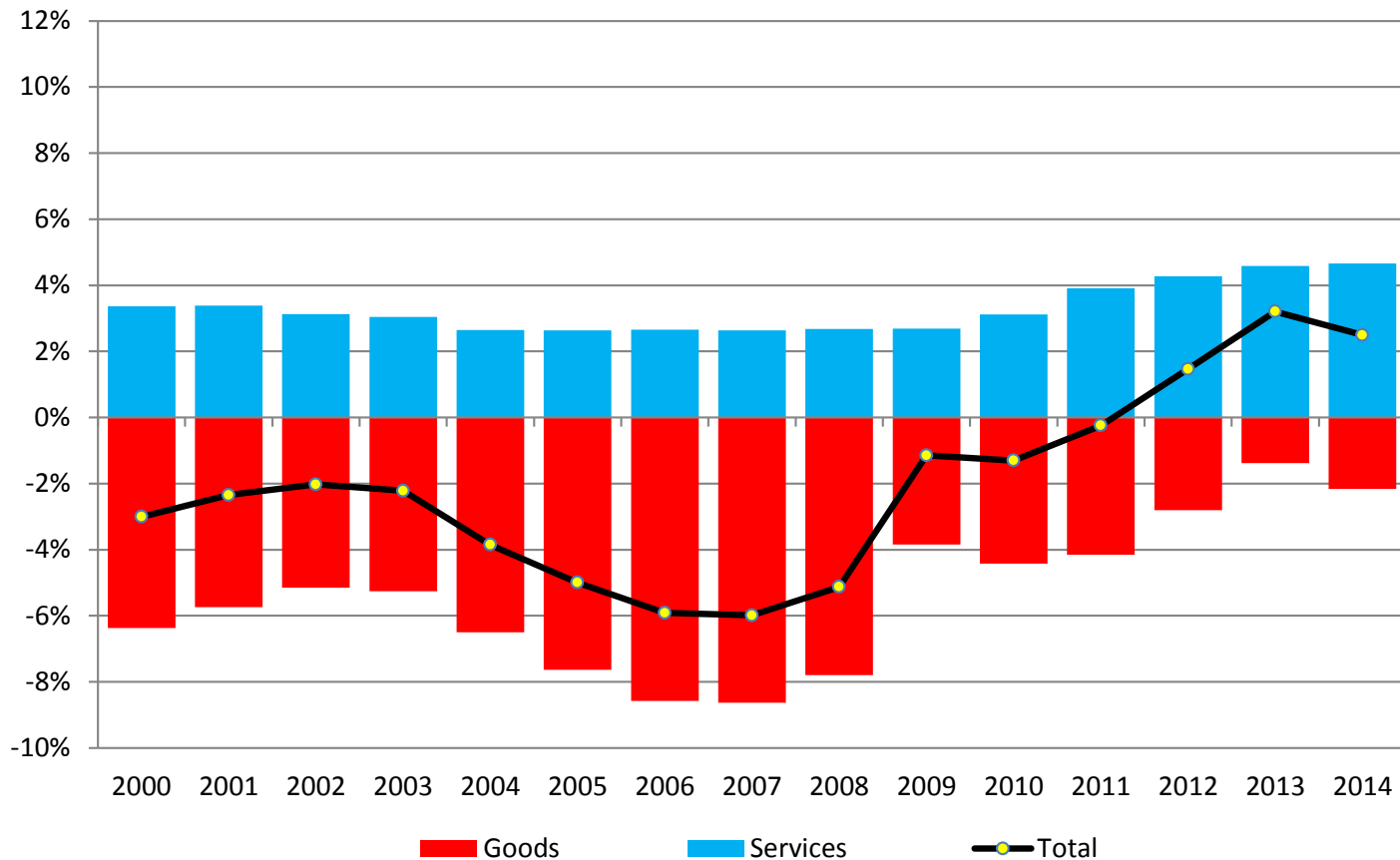
IMF



External Balance of goods & services as % of GDP

Eurostat

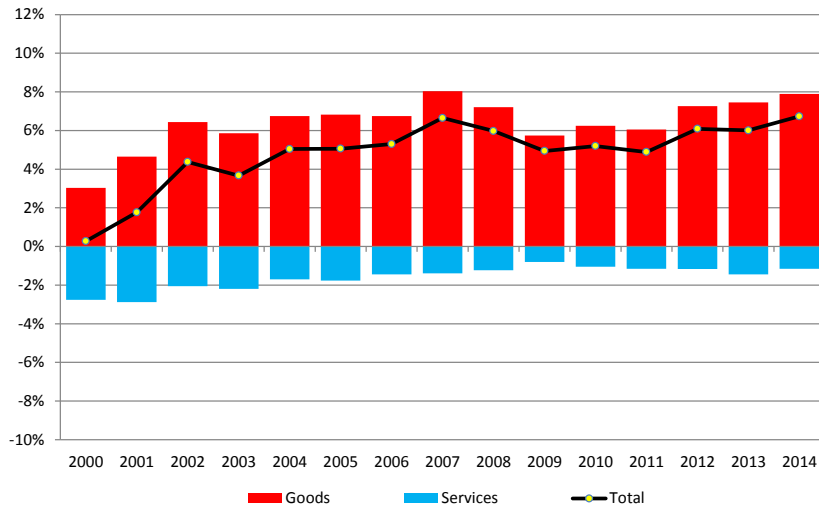
Spain



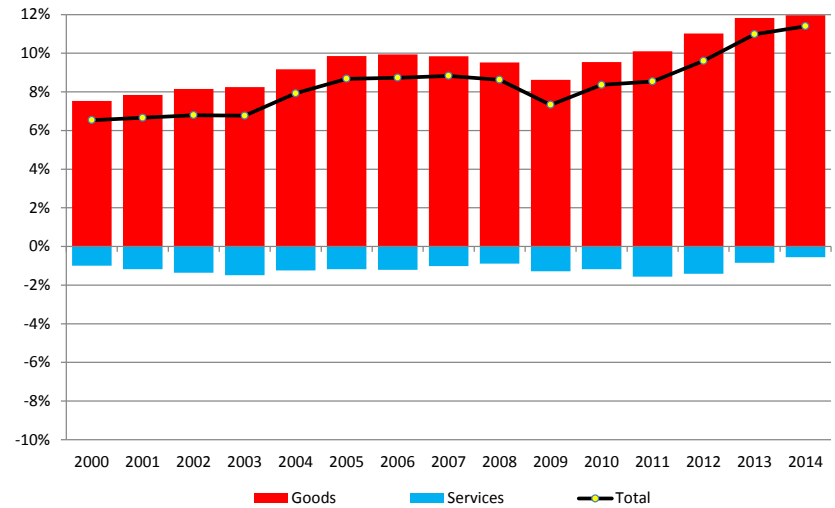
External Balance of goods & services as % of GDP

Eurostat

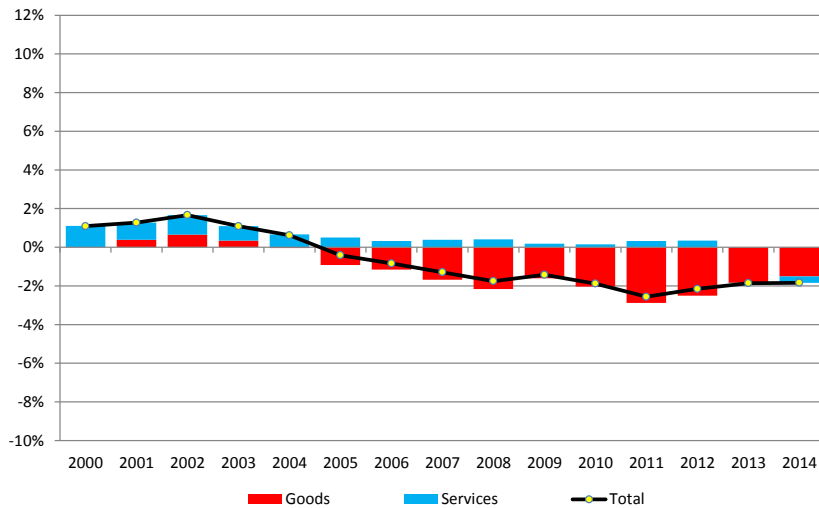
Germany



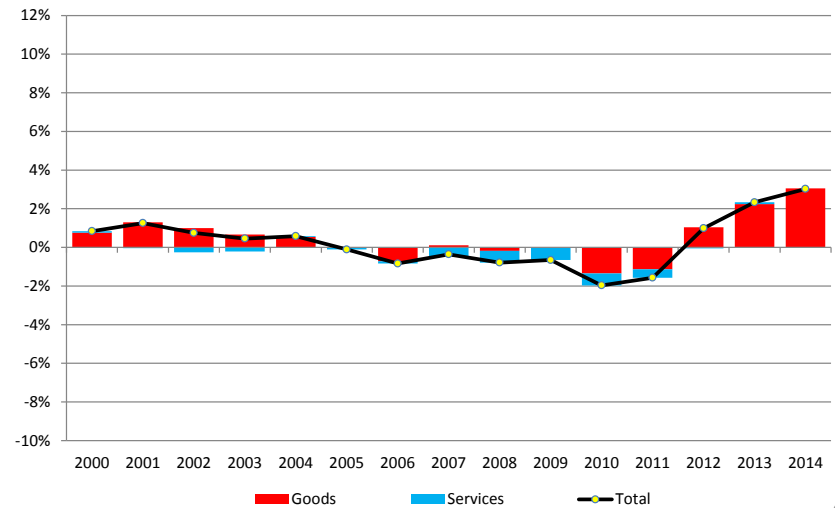
The Netherlands



France



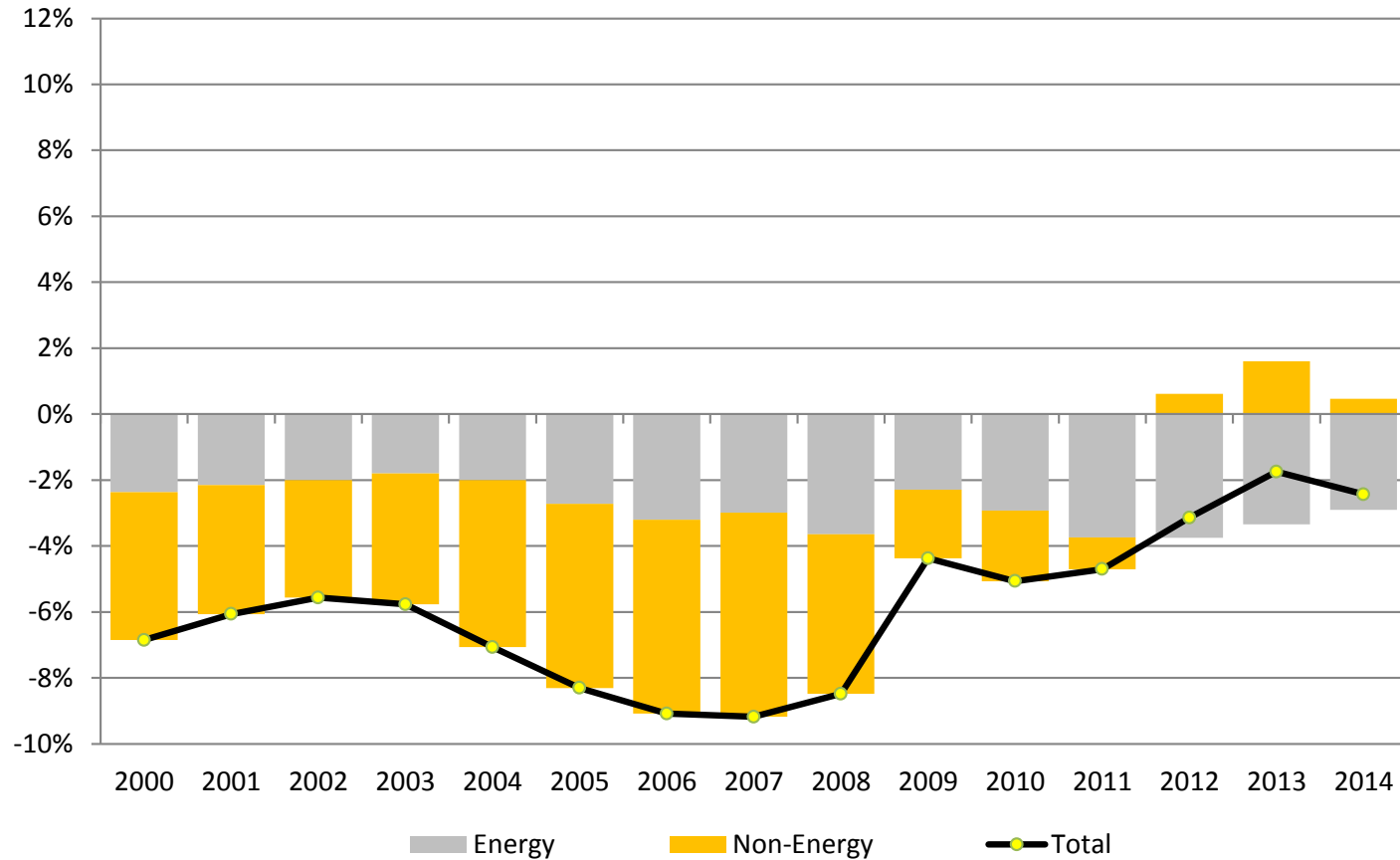
Italy



Net exports of goods by product type as % of GDP

Eurostat. Note. Energy = SITC06.

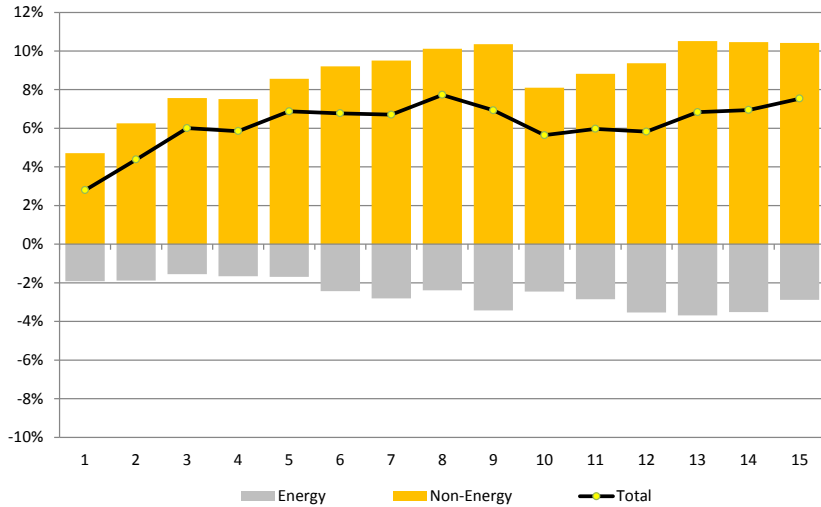
Spain



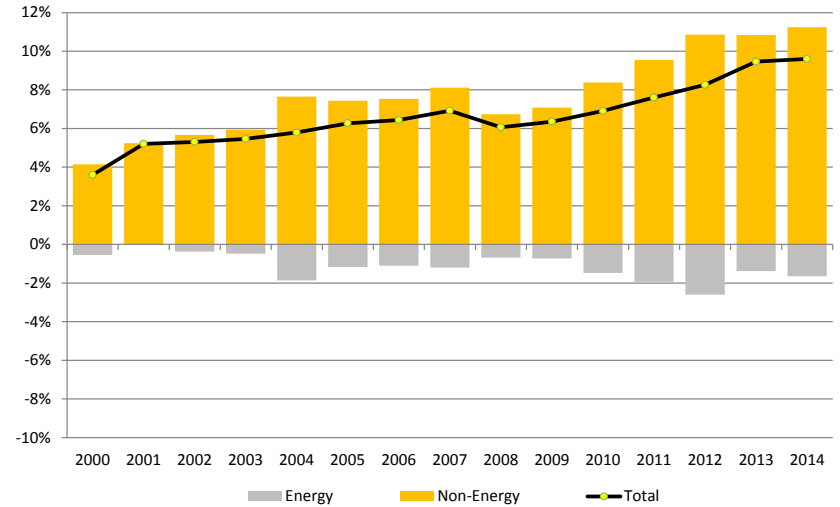
Net exports of goods by product type as % of GDP

Eurostat. Note. Energy = SITC06.

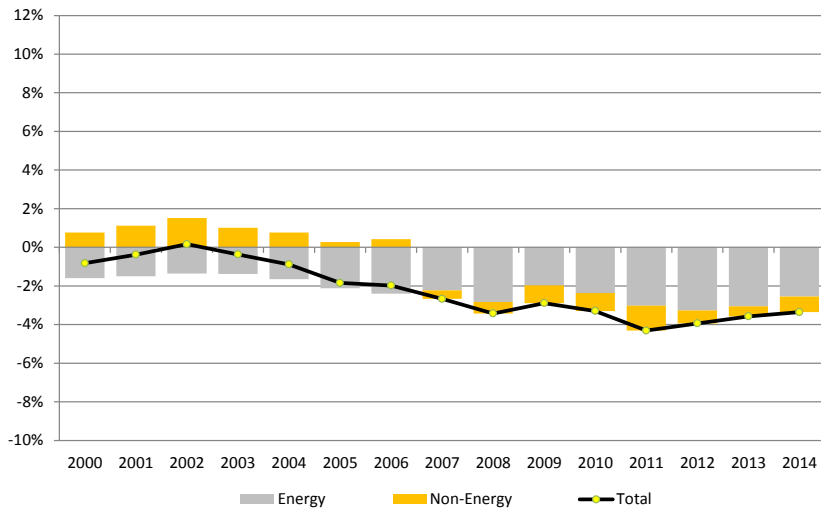
Germany



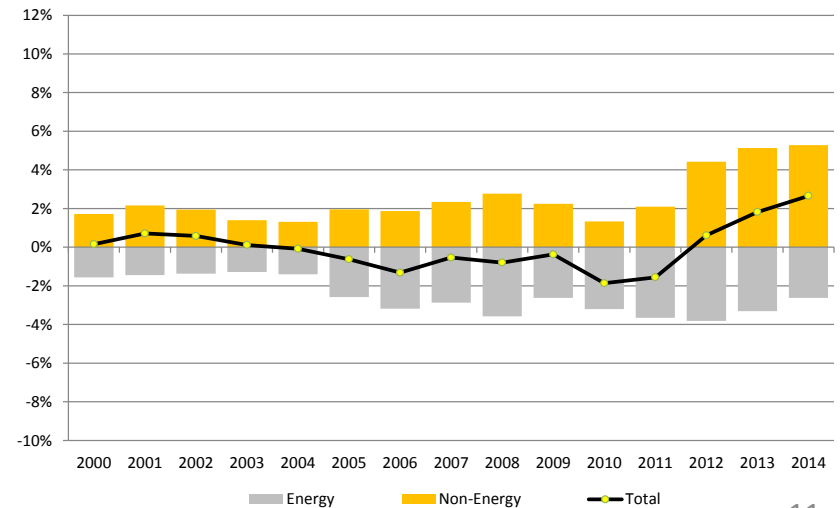
The Netherlands



France



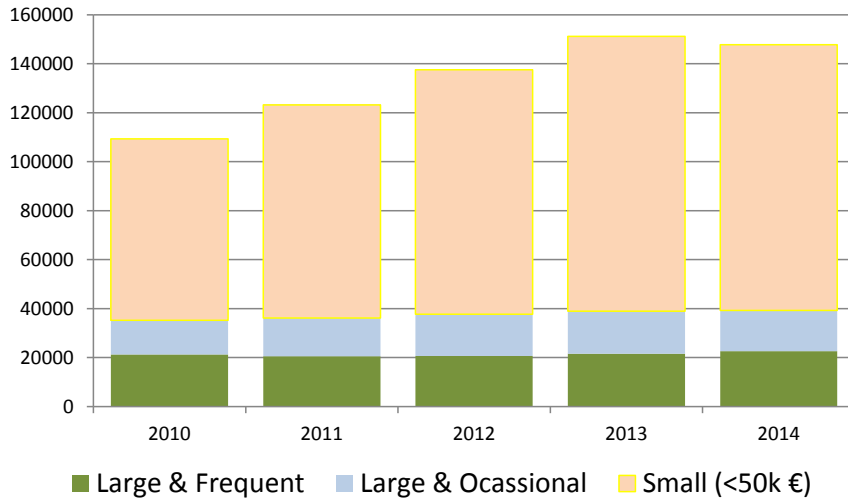
Italy



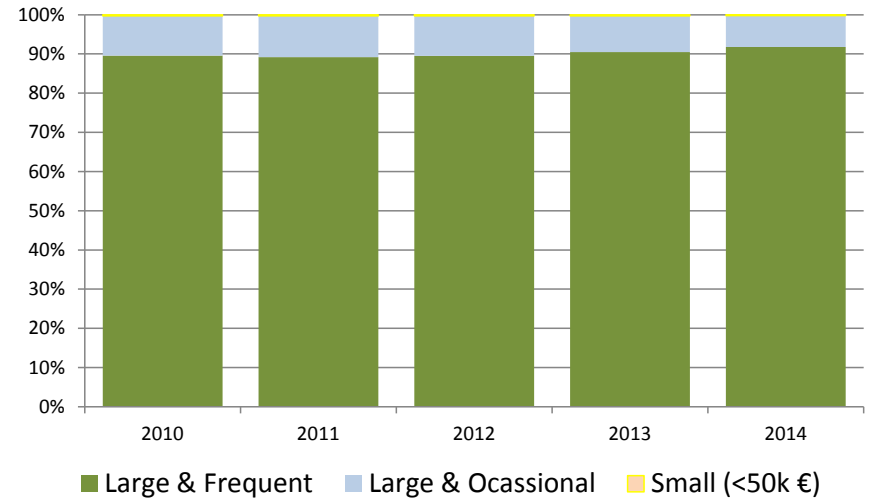
Exporting firms in terms of size and type of exporting activity

ICEX

Number of firms



Share in export volume



2014

<u>Firm's export volume</u>	<u>Number</u>	<u>Firms % of total</u>	<u>Exports as % of total</u>
> 250 M. €	95	0.1%	39.7%
50 - 250 M. €	449	0.3%	18.8%
5 - 50 M. €	4153	2.8%	24.9%
All > 5 M. €	4697	3.2%	83.4%

Recovery in the labour market

Well-known facts

- Spain is finally creating net employment: the unemployment rate peaked in mid 2013 and since then the labour market has continued to recover. The most recent data show that in 2015Q2, there are less than 5 M. unemployed, a level not seen since 2011.

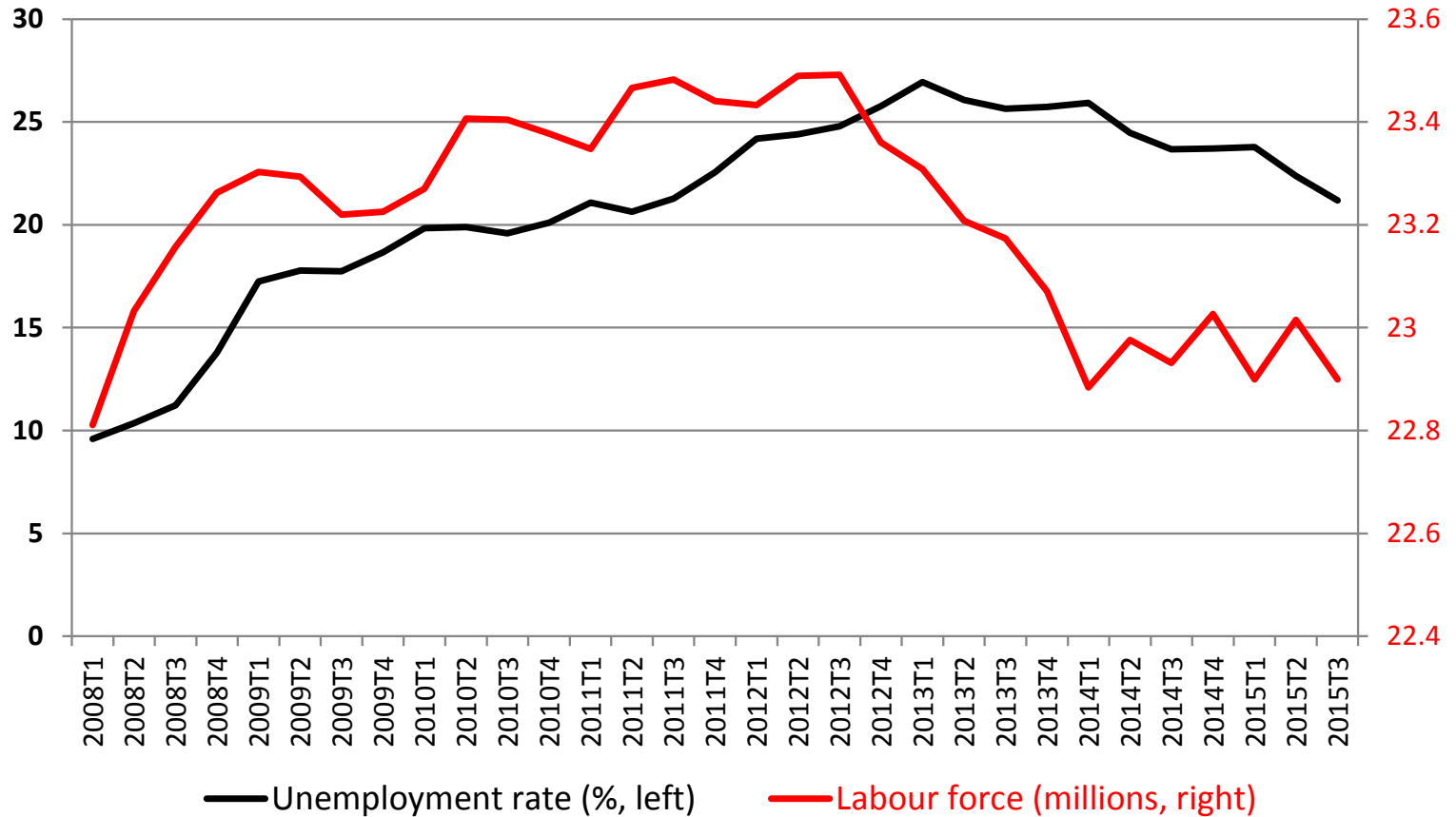
Complementary evidence

The recovery in the Spanish labour market is peculiar:

- The fall in the unemployment rate was preceded by a fall in the active population.
- Since the 2012 reform, the net employment growth is the result of adding **two** temporary contracts and removing **one** permanent contract.
- Even if the unemployment rate is falling, the share of long-term (> 2 years) job seekers within the unemployed has soared (11% in 2008 and 44% in 2015). The risk of exclusion of the labour market increases with the length of the unemployment spell.

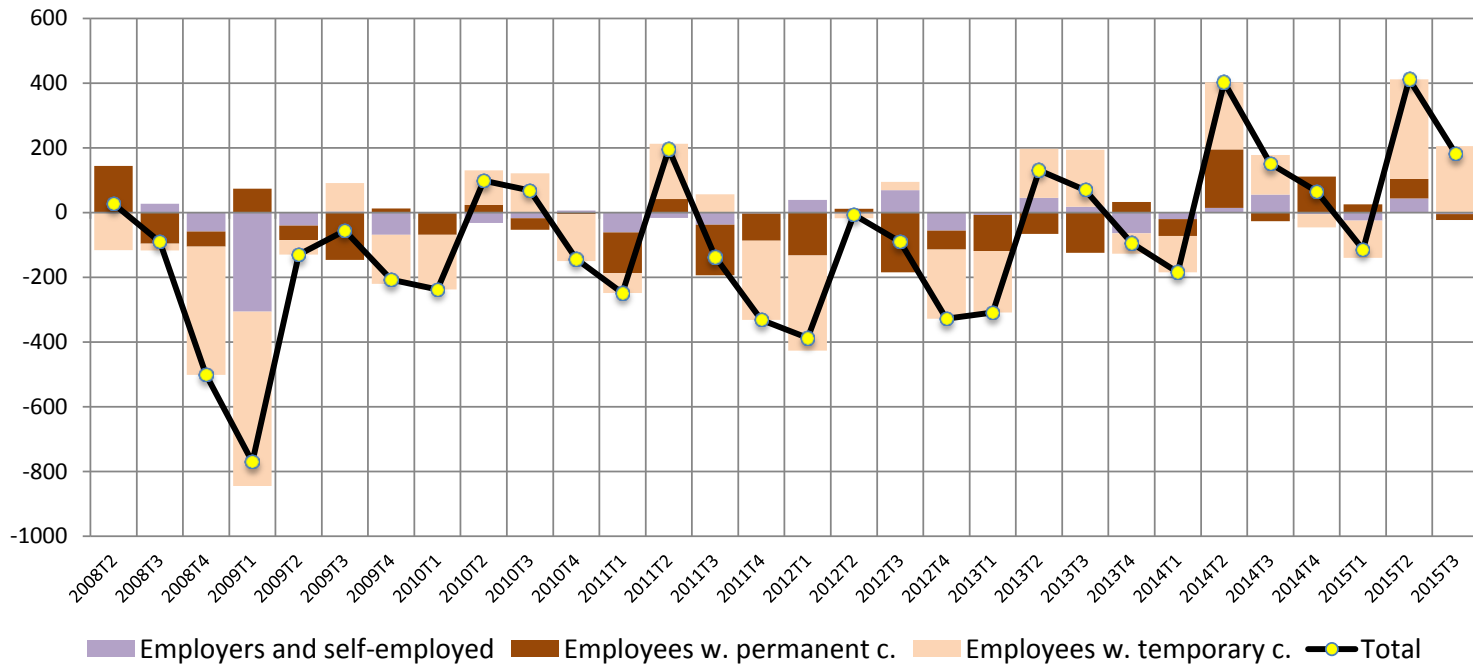
Unemployment rate (%) and labour force (millions)

INE



Unemployment QoQ variation (thousands) by type of contract

INE



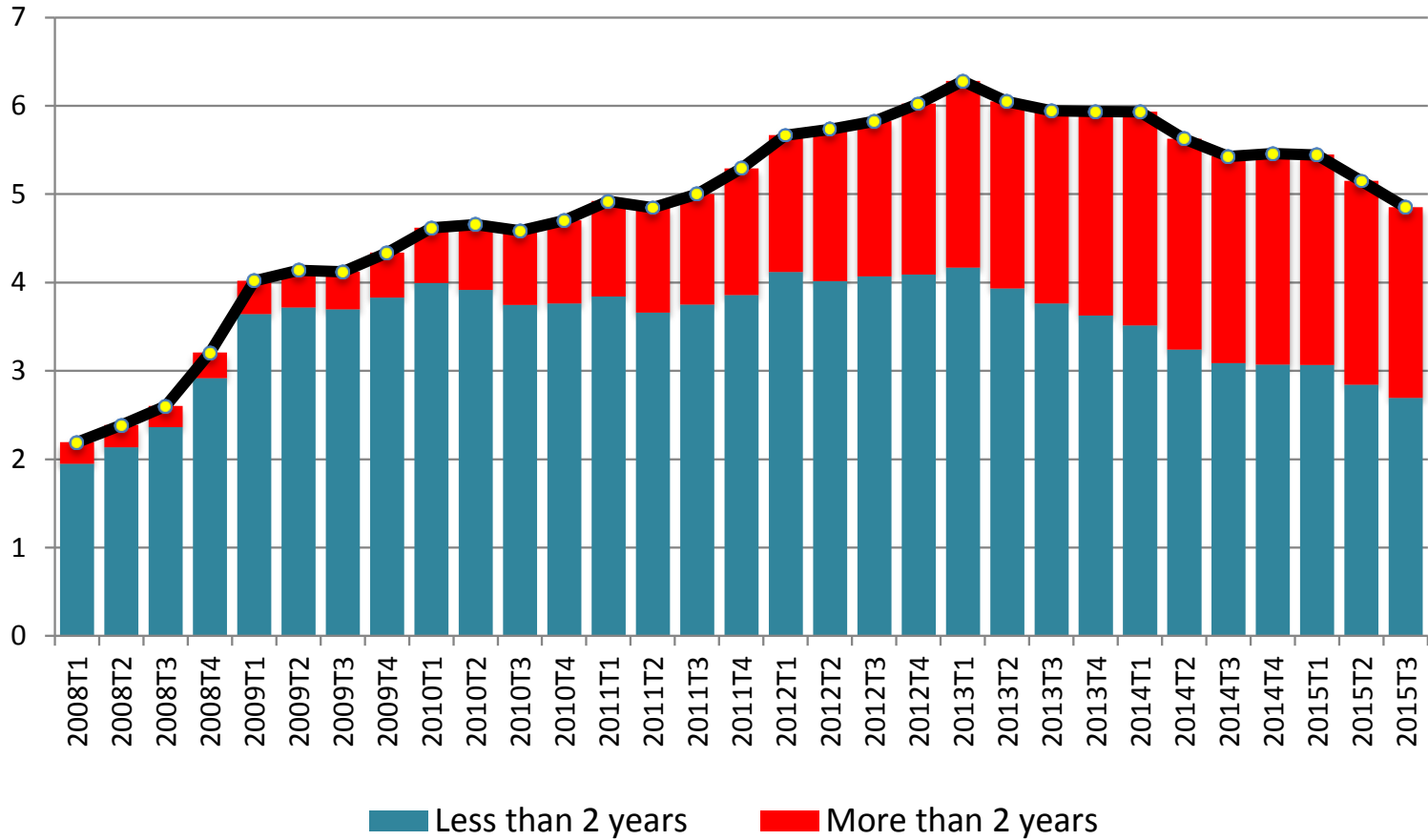
Unemployment variation

Thousands

	Crisis I	Crisis II	Reform	
	2008-Q2	2010-Q3	2012-Q3	2008-Q2
	2010-Q3	2012-Q3	2015-Q3	2015-Q3
Total	-1801.0	-1083.4	290.2	-2,571.3
Employers and self-employed	-496.0	-24.4	61.7	-510.1
Employees w. permanent c.	-182.6	-672.9	-232.6	-867.5
Employees w. temporary c.	-1122.3	-386.1	461.2	-1,193.7

Unemployment (millions) by length of job search

INE



Internal devaluation – The sacrifices pay out

Dominant narrative

- The combined effect of the multiple reforms adopted in Spain (containing labour costs, improving productivity, strengthening competition, etc.) is that the Spanish economy is regaining price/cost competitiveness. This is a permanent gain that supports the recovery.

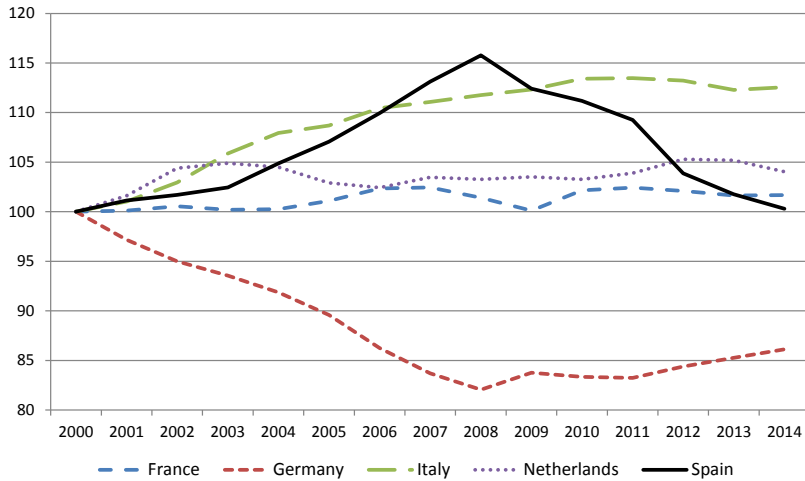
Complementary evidence

- By most available measures of price/cost competitiveness, Spain initiated the internal devaluation in 2009-2010, not in 2012. This is more likely to be an “automatic” adjustment undertaken by the private sector rather than the outcome of deliberate policy reform.
- Interestingly, the prices of Spanish exports appear not to be falling but rather mildly increasing. Given that this is coupled with increasing exports, it is problematic to argue that the Spanish export success fundamentally relies on “low-cost” expansion.

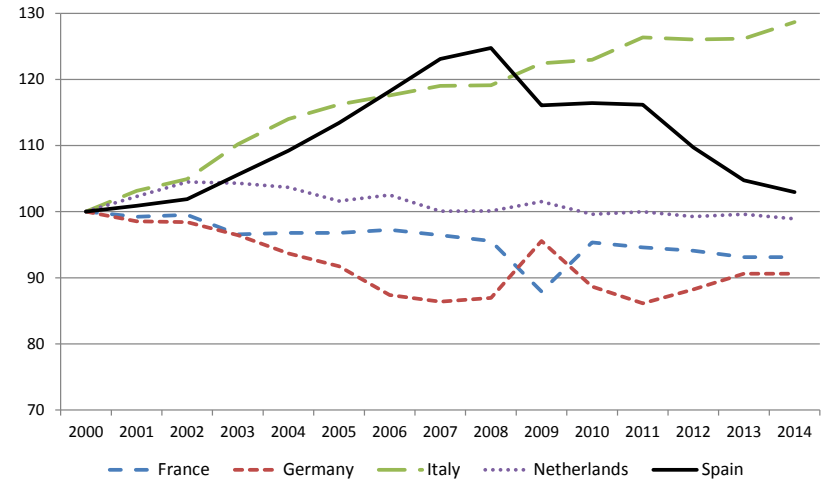
Real Effective Exchange Rate (REER) vs EA 19 (2000 = 100)

ECFIN

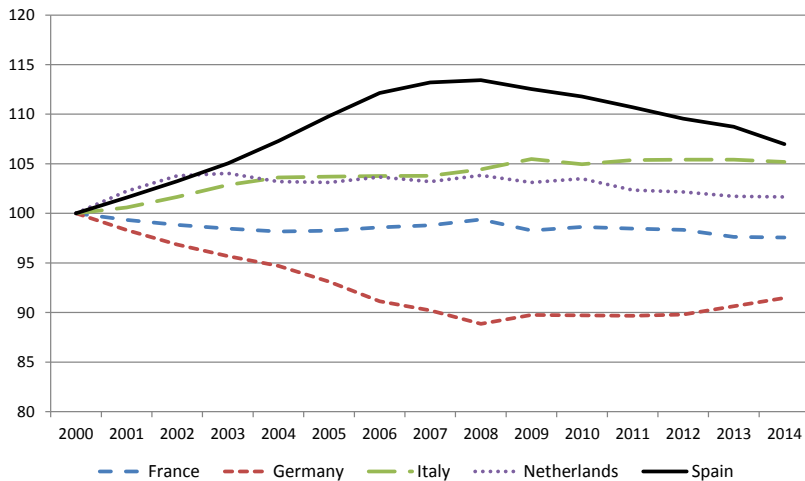
ULC, total economy



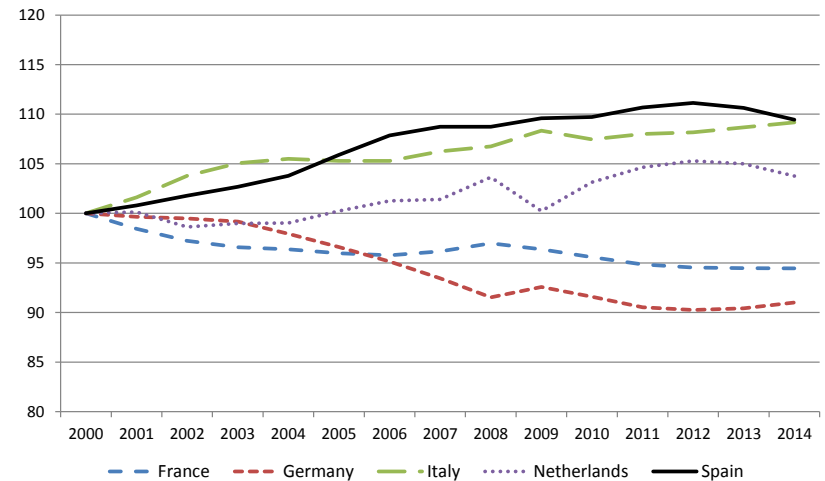
ULC, manufacturing



Price deflator GDP



Price deflator, exports



Conclusion

- The Spanish economy is clearly recovering. In some respects, its recent trajectory and most likely forecasts are better than in other large Euro Area countries.
- The key issue is whether this is due mainly to adopting the right policy reforms or, instead, the grounds of the recovery are manifold and mostly external (BCE's QE, improved confidence in EU economic governance, markets' shift of focus). Is the recovery secured and “structural” or the cyclical component dominates?
- There is not strong evidence to argue that the main reforms adopted in Spain since 2012 (labour market, financial system, deficit control) have contributed **significantly and directly** to the recovery.
- In addition, key reforms in many areas appear to be frozen during two consecutive Governments (public administration, education, knowledge economy, smart regulation, competition policy).
- A comprehensive reform program is urgently needed. It should also take good care of the redistributive consequences of the policies adopted so far (labour market “precarariat” and cuts in social expenditure).