

Structural Reforms and the Spanish Recovery

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The crises of others: Greece and the Eurozone periphery

The Foundation for Economic and Industrial Research - IOBE
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Main messages

1. After six years of crisis, Spain is finally recovering due to a **favourable combination of external and domestic factors**
2. Although it is difficult to estimate their exact contribution, behind the current economic recovery are **the effects of structural reforms**, in labour and product markets, the financial system or the public sector
3. Current **employment growth is consistent with a more balanced recovery**, in contrast with the growth pattern previous to the crisis
4. **To ensure a sustainable and inclusive growth** it is key to **continue the process of structural reforms** to reduce structural unemployment, and increase **competitiveness and size of firms, productivity and quality of jobs, human capital and the quality of institutions.**

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Structural reforms as a driver of the economic recovery

Section 2

Main structural reforms implemented

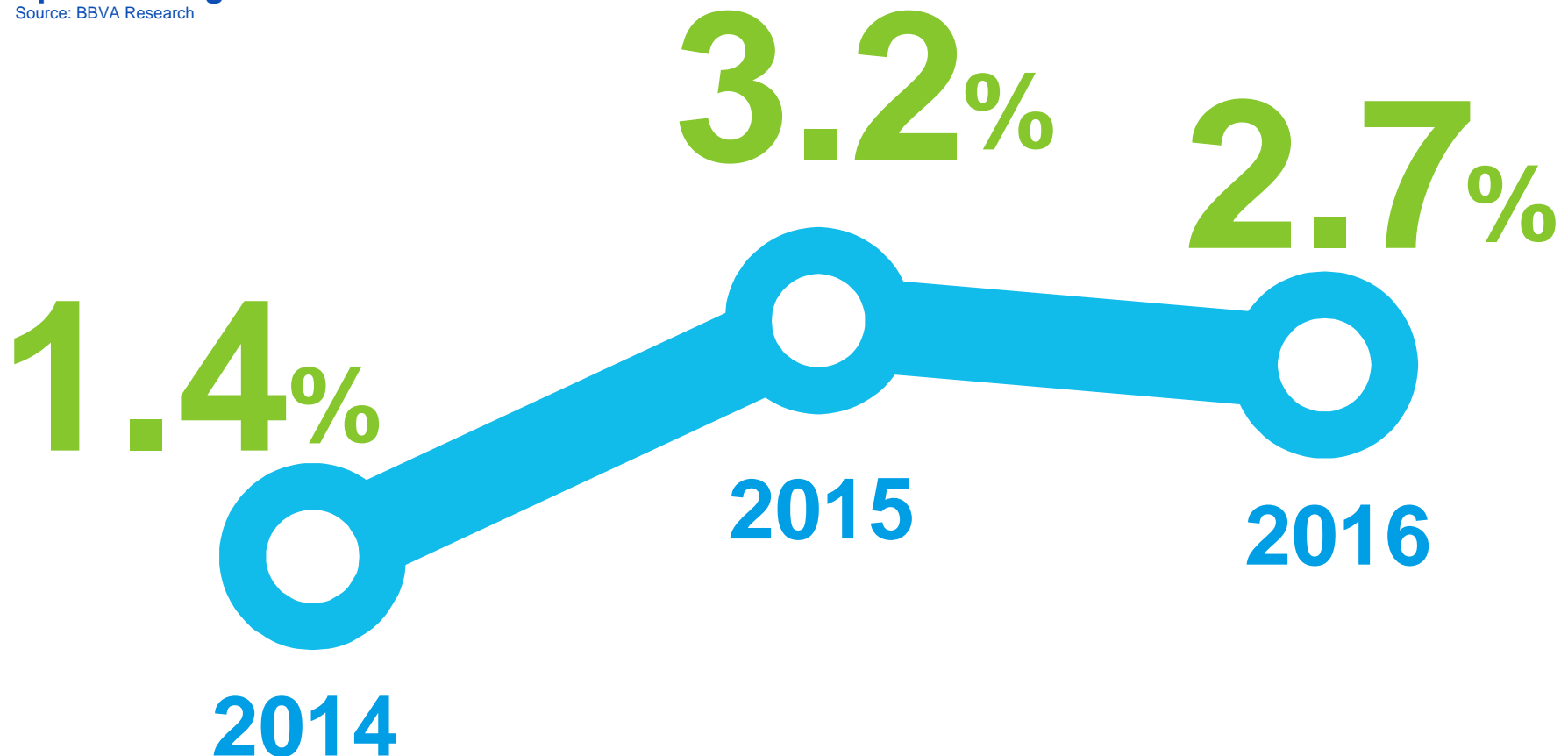
Section 3

Continuing the process of structural reforms to ensure a sustainable and inclusive growth

Spain is finally recovering due to a favourable combination of external and domestic factors

Spain: GDP growth

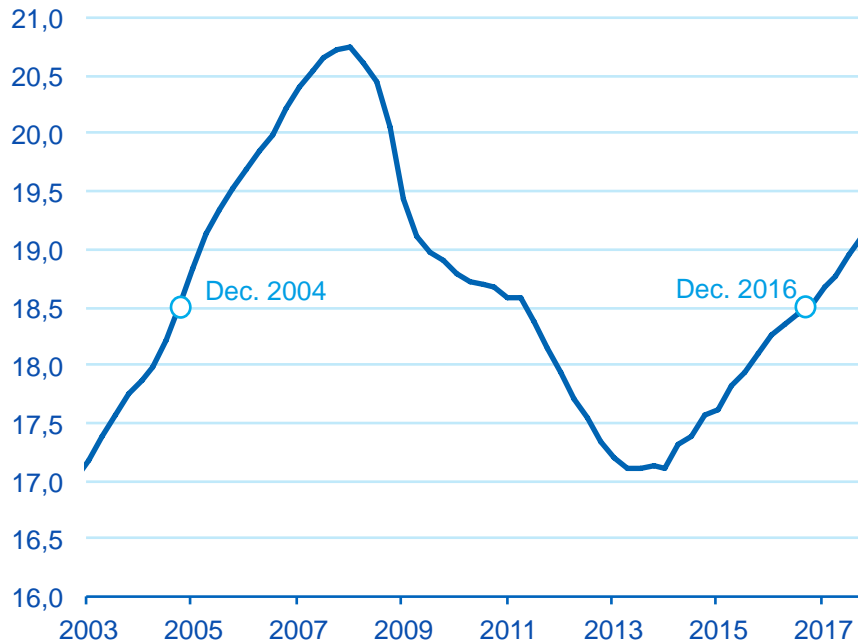
Source: BBVA Research



Spain is finally recovering due to a favourable combination of external and domestic factors

Spain: Employment (LFS, millions)

Source: BBVA Research based on INE



Between 2014 and 2016 almost 1.5 million jobs will be created

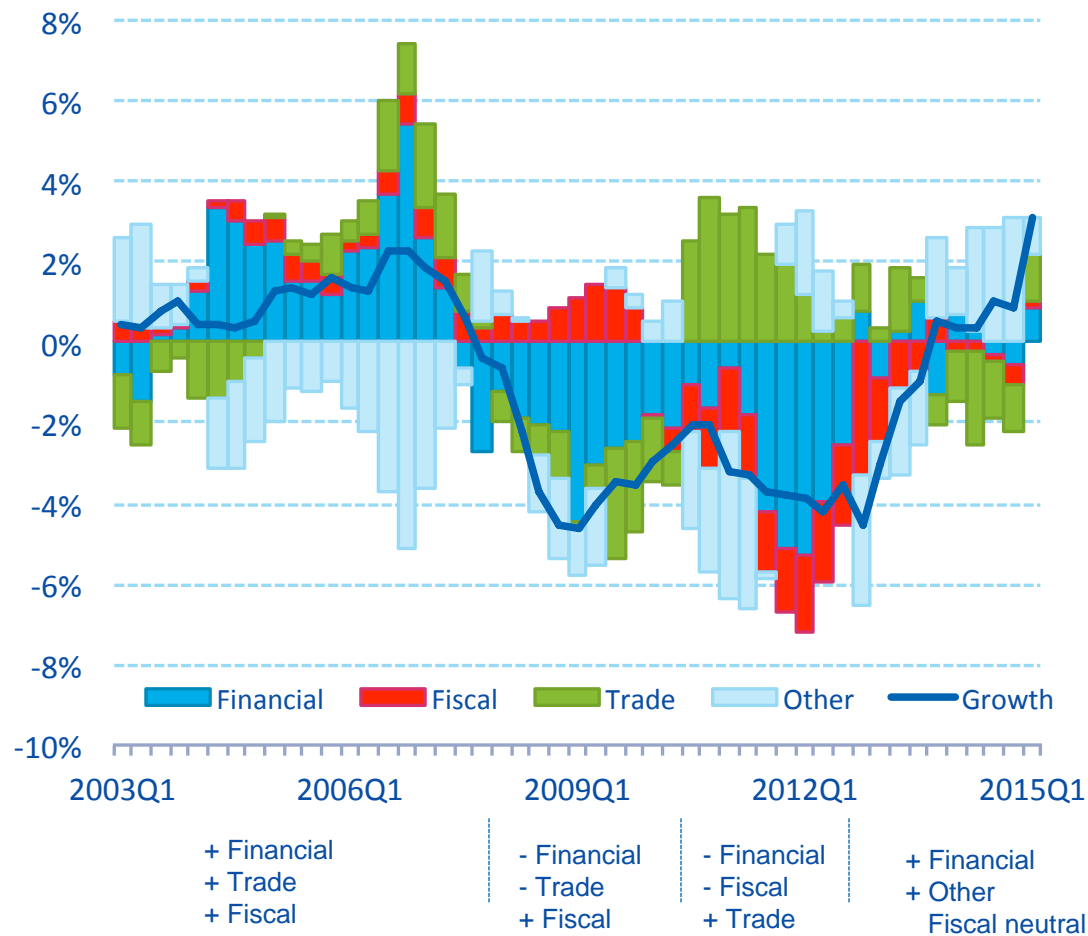
By 2016, employment could be back to the level at the end of 2004 ,,

... and GDP per capita to the 2008 level

Spain is finally recovering due to a favourable combination of external and domestic factors

Spain: GDP growth (cyclical component)

Source: Preliminary results by Boscá et al (2016)



Spain is finally recovering due to a favourable combination of external and domestic factors

External factors

- ECB monetary policy
- Euro depreciation
- Banking union
- Lower oil prices

Domestic factors

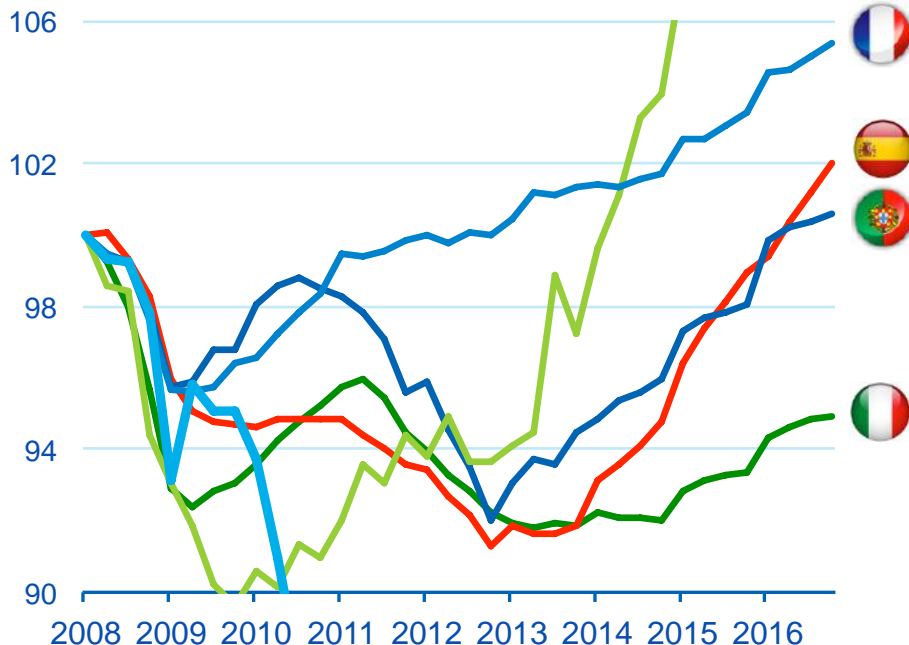
- Internal forces of a free market economy
- Structural reforms
- More expansive fiscal policy

Alternative explanations not supported by the evidence

 118.3%

GDP per working-age population

Source: BBVA Research and European Commission



An alternative explanation: the recovery is just the natural rebound from a very deep recession and common external conditions

This could explain differences with France but not with other countries, as Italy and, more significantly, as Greece

Other countries as Portugal and Ireland have also implemented important structural reforms

 80.2%

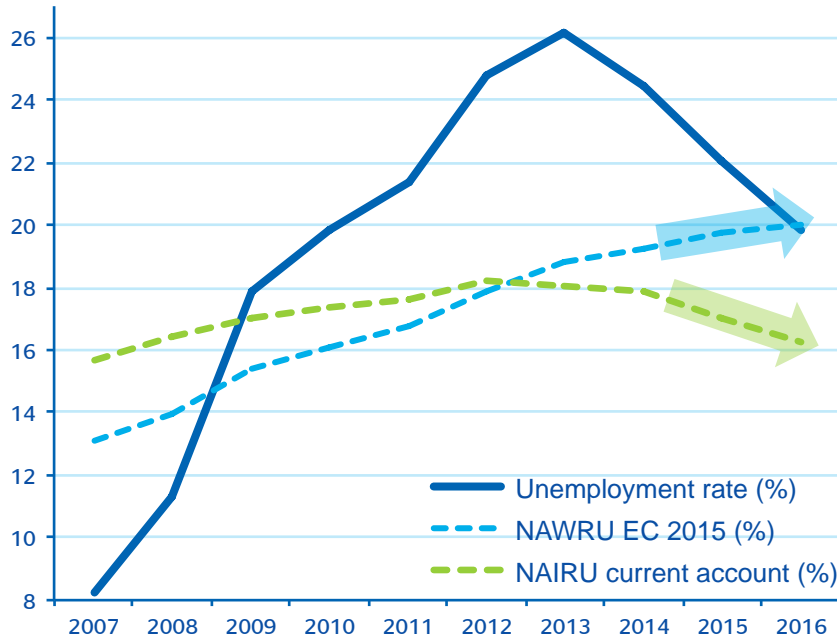
Uncertainty on the effects of structural reforms

- If structural reforms are behind domestic factors, which is the contribution of structural reforms to the economic recovery?
- Difficult question without a straightforward answer:
 - Short time span after the reforms for a proper evaluation
 - Counterfactual exercises: we have to rely on models that, in many cases, have not been designed for the evaluation of the reforms
 - Many reforms interact simultaneously making difficult to disentangle their effects
 - Academic debate: structural reforms in a ZLB: Eggertsson, Ferrero and Raffo (2014), Krugman (2014), Andrés, Arce and Thomas (2014)

Example: estimation of structural unemployment rate

Spain: structural unemployment rate estimates

Source: BBVA Research and European Commission (2015)



The structural unemployment rate is a non-observable variable

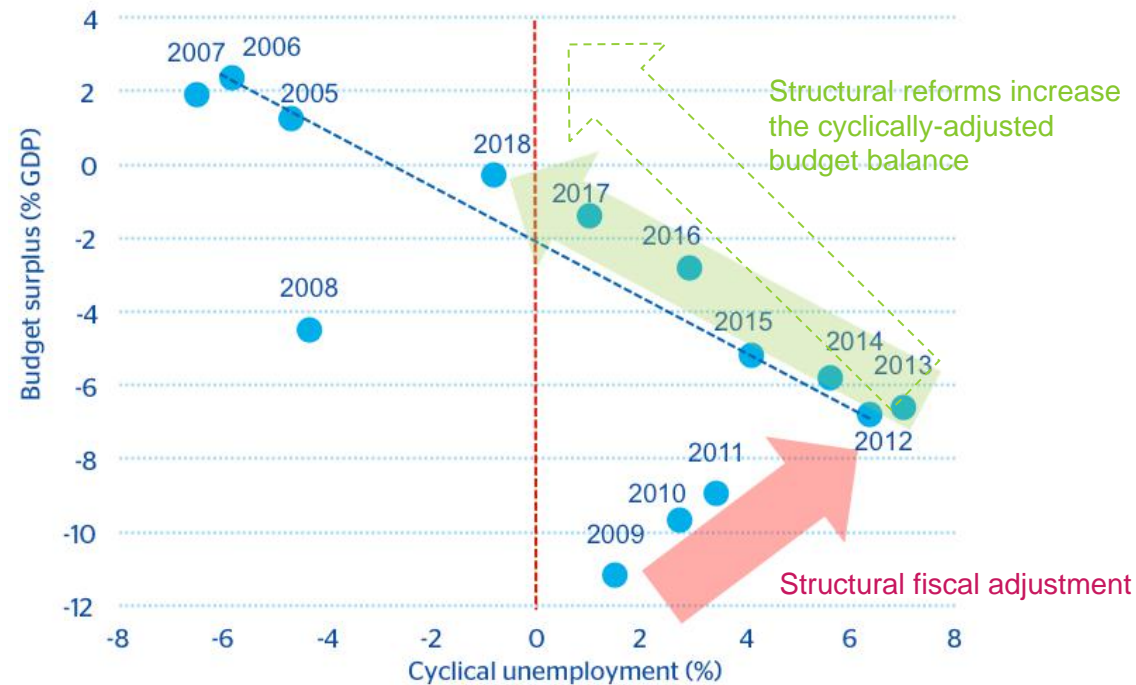
According to the EC, structural unemployment will be surprisingly still growing in 2016 despite structural reforms

Alternative estimates suggest a decrease after the labour market reform in 2012

Implications for the fiscal adjustment

Spain: unemployment rate and budget balance of general government, 2005-2018

Source: BBVA Research based on INE and the Updated Stability Program (2015)



Note: Structural unemployment assumed to remain constant at 18% from 2014 onwards in the dots representing the Updated Stability Program. A reduction of the structural unemployment rate increases the slope of the fiscal adjustment path, as in the arrow with a dashed line.

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Main structural reforms implemented

Labour
market

Policies
to foster
competition

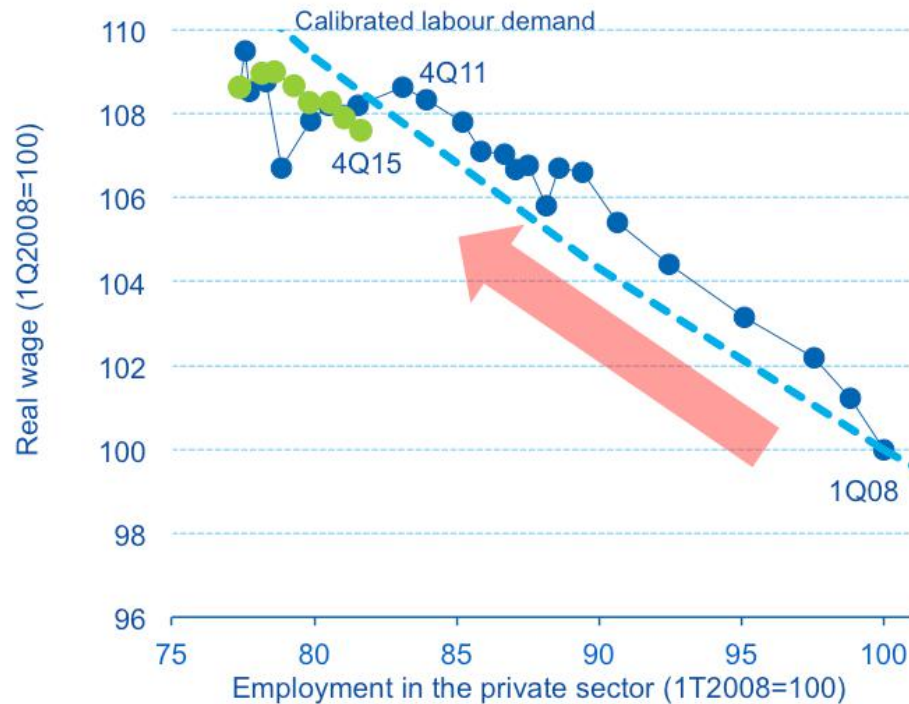
Better public
finances

Financial
sector

A very rigid labour market until 2012 ...

Spain: private employment and real wages

Source: BBVA Research based on INE.



A very rigid labour market: adjustment in employment instead than in wages and hours per worker

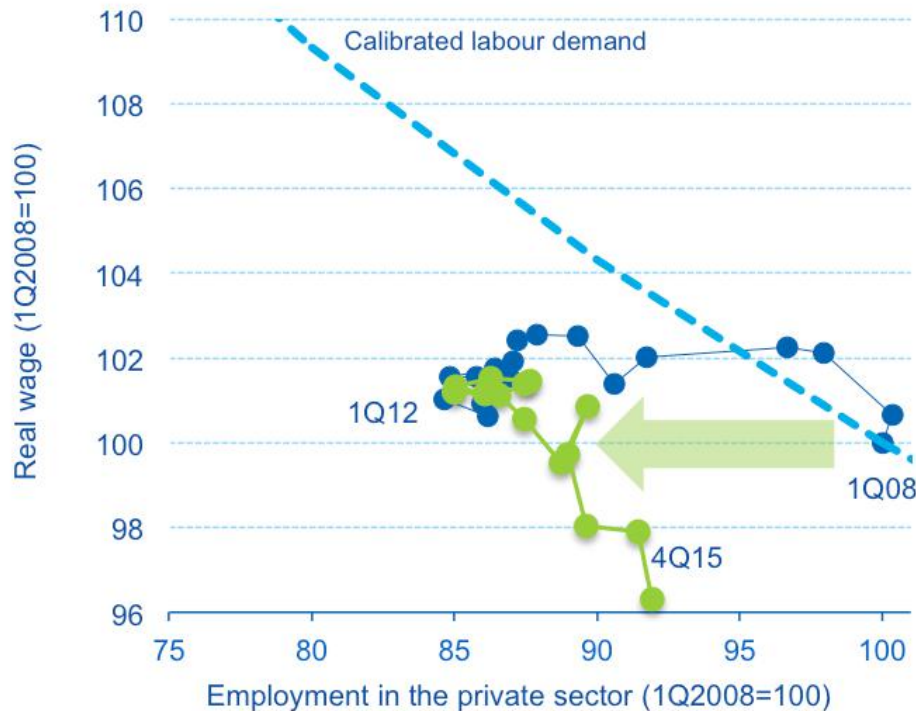
A dual labour market with a very high rate of temporary employment: *flexrigidity*

From 2008 to 2011 wages increased by 8,6% and private employment fell by 16,9%

... in contrast to the flexibility in other countries

Ireland: private employment and real wages

Source: BBVA Research based on INE.



Ireland: more flexible labour and products markets

From 2008 to 2011 internal prices (GDP deflator) fell by 5% (almost 0% in Spain)

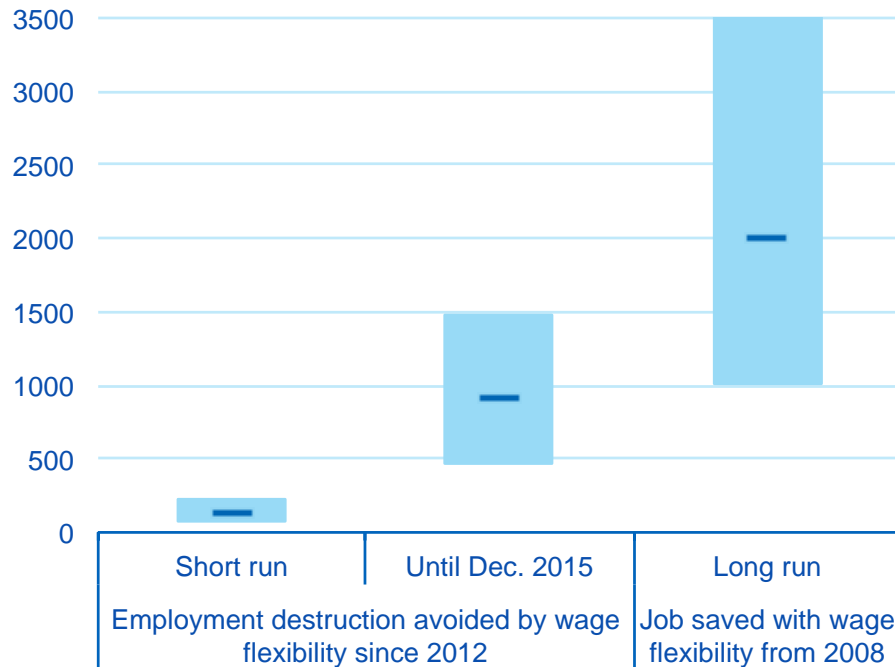
From 2008 to 2011 wages increased by 0,6% and private employment fell by 14%

Labour market (1): more internal flexibility after 2012

Spain: effects of wage flexibility from 2012 on employment

(Thousands of full-time equivalent jobs)

Source: Doménech, García and Ulloa (2016)



The 2012 Labour market reform and the 2nd Agreement on Employment and Collective Bargaining prevented greater job destruction

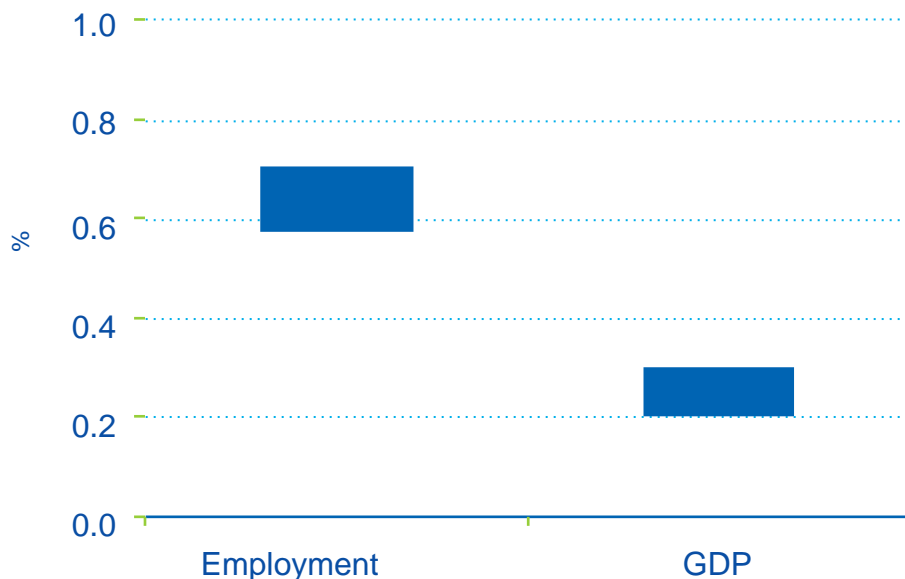
Without the greater wage flexibility of 2012, an additional 950K jobs would not have been created from 2013 to 2015

Wage flexibility from the beginning of the crisis might have prevented the destruction of almost 2 million jobs

Labour market (2): other labour market policies

Spain: effects after a year of the flat contribution to Social Security for permanent contracts

Source: BBVA Research)



Estimated effects on employment of the 2014 tax incentive for permanent contracts 0.6-0.7%
In 2015 a better incentive has been introduced

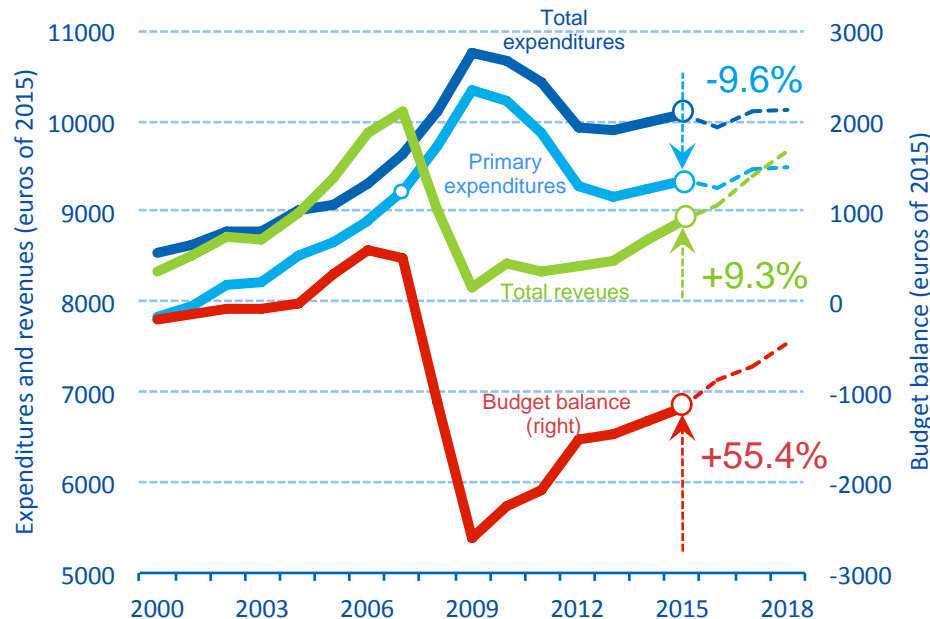
- More flexible part-time contracts
- Spanish Strategy for Employment Activation
- New reform in in-job professional training

- National youth guarantee system
- Better ALMP (new employment strategy, PPP in intermediation, ...)

Better public finances (1): fiscal consolidation

Main public sector aggregates in per capita terms (euros of 2015)

Source: BBVA Research based on MINHAP, Stability Program Update 2015-2018



A sizeable fiscal adjustment from 11.2% of GDP in 2009 to 5% in 2015: a reduction of 55.4% in per capita terms ...

... that has been the result of a reduction in public expenditures (excluding interests) of 9.6%, but still slightly above pre-crisis levels ...

... and an increase of 9.3% in public revenues.

Better public finances (2): institutional improvements

1. Constitutional Reform, Budget Stability Law and Reform of Local governments reinforce the long-run commitment to a zero structural deficit and public debt below 60% of GDP

2. Commission for the Reform of the Public Administration (CORA) to increase efficiency: estimated savings from 2012 amount 2% of GDP

3. Law for Transparency in public administrations: better transparency and efficiency

4. Independent Fiscal Authority (AIReF)

Better public finances (3): pension system reforms

2011 Pension Reform

(Law 27/2011, from 2013 onwards)



Retirement age from 65 to 67y
More contributed years (15-> 25)
to compute initial pension & more
years (37) to full pension

2013 Pension Reform Sustainability factor for new pensions

(Law 23/1013, from 2019 onwards)



New pensions computed taken into
account the increase of life
expectancy

2013 Pension Reform Index for annual nominal growth of the public pensions

(Law 2371013, from 2014 onwards)

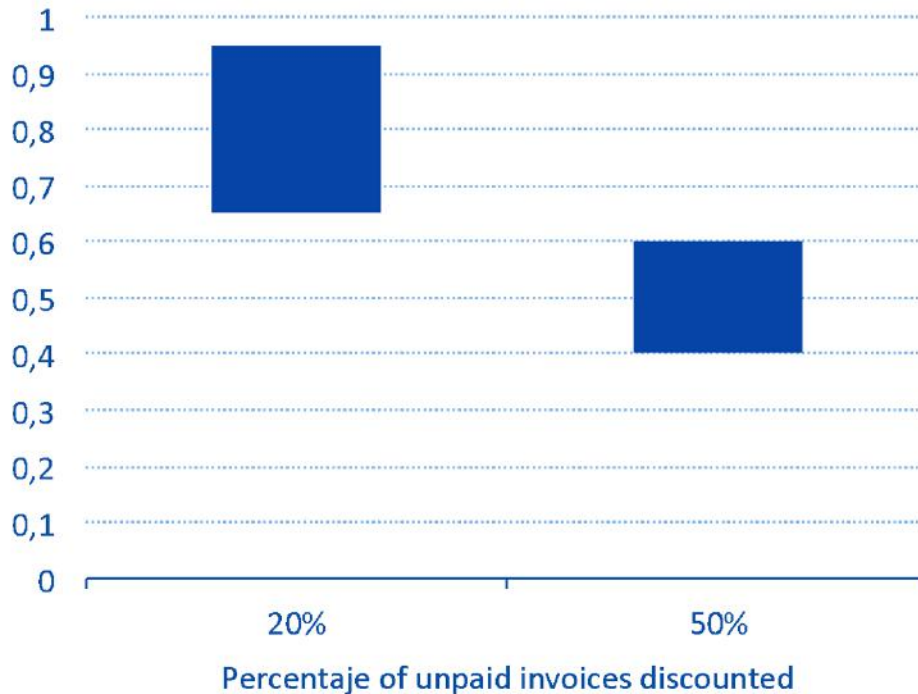


+ Structural revenues
- Structural expenditures
- Deficit correction component

Better public finances (4): liquidity management

GDP impact on 2012 from the Supplier Payment Programme (pp of GDP)

Source: BBVA Research based on MINHAP



In 2012 the Government injected 2.5% of GDP (€27bn) to pay off local and regional government debts with suppliers

From 2012 to 2015 these liquidity measure to suppliers amount €70,6bn (6.7% of GDP)

The total amount of all liquidity measures to regional and local governments from 2012-15: €184bn (17.4% of GDP)

*/ Max and Min depend on agents' level of liquidity restriction

Policies to foster competition

1. Implementation of Law on Guarantee of Market Unity: freedom of movement and establishment of businesses among Spanish regions.
Doing Business at the regional level to promote internal competition

2. Measures to reduce the time, cost and number of procedures in public administrations for setting up an operating business. Address restrictions to the establishment of large-scale retail

3. The Deindexation Law has introduced the Competitiveness Guarantee Index to be used for price updating in the public sector. The index automatically corrects cumulative price differentials with the rest of EMU

4. The Entrepreneurship Law, measures to facilitate debt recovery and restructuring (2014 and 2015) for firms and entrepreneurs and reform of the insolvency regime

Restructuring the financial system (1)

Phase 1 of the restructuring

2008

Creation of FAAF and increased coverage of DGF

2009

Creation of FROB. Injection of 10bn € into savings banks

2010

Reform of legal framework of savings banks

2011

Minimum capital requirement of 8% (general) or 10%

Phase 2 of the restructuring: asset valuation, stress tests and capital increases

Feb-May 2012

New regulation: 80bn € in provisions and capital buffers

June-Sep 2012

Financial assistance program, MOU and capital needs by bank

Post-MOU

Creation of Sareb and asset valuation in the European banking union and stress tests

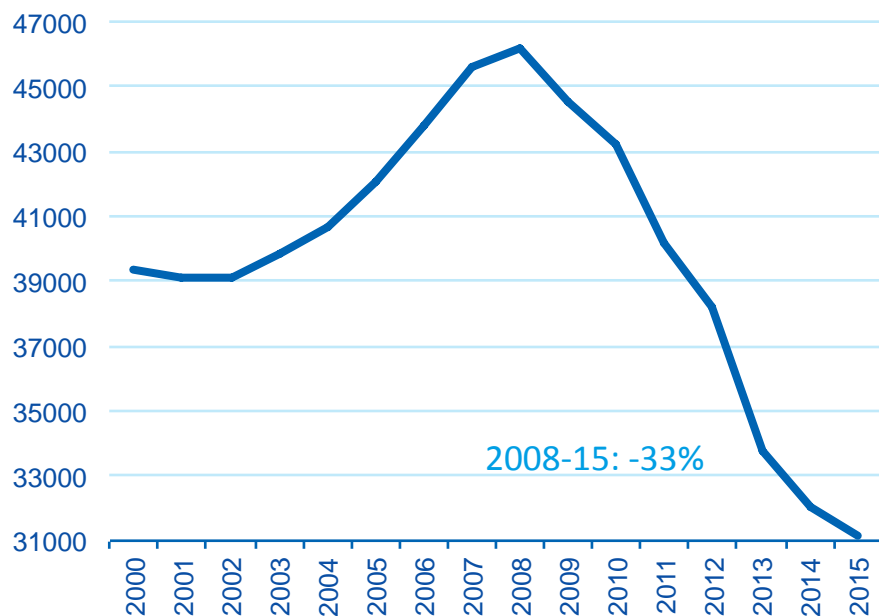
2014-5

New legislation promoting capital markets and the ECB as single supervisor

Restructuring the financial system (2)

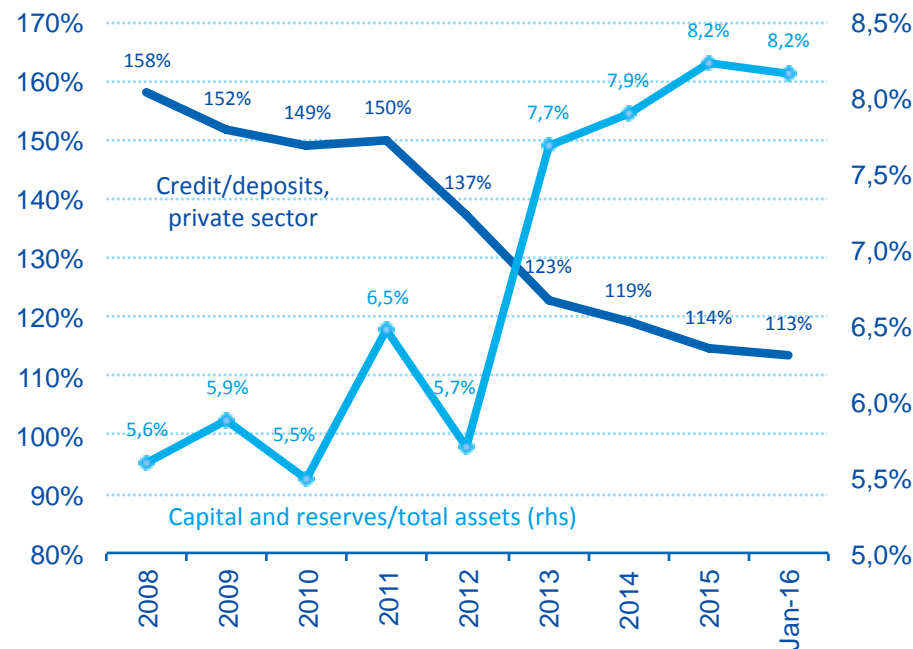
Number of branches of Spanish banks

Source: BBVA Research based on Bank of Spain



Solvency and liquidity of Spanish banks

Source: BBVA Research based on Bank of Spain

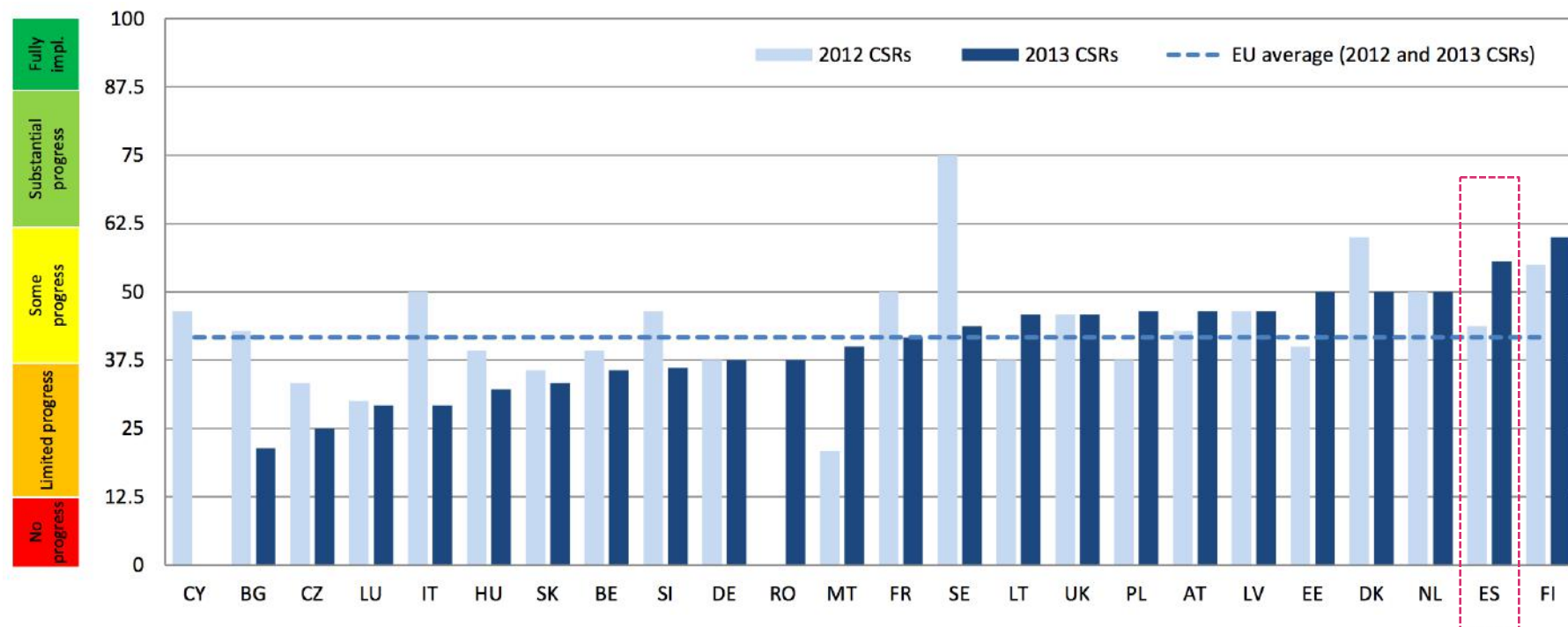


As a result of the restructuring process, the Spanish banking system was the best performer in the 2014 AQR exercise and the third in the stress tests

Implementation of country specific recommendations

Synthetic indicator of progress on implementation of 2012 and 2013 CSRs

Source: ECFIN Economic Brief, 37 (2014) <http://goo.gl/KMuN10>



Effects of structural reforms and adjustments

ULC growth 2003-2007
3.5% Spain vs 1.5% EMU



ULC growth 2014-2016
0.0% Spain vs 0.9% EMU

GDP deflator growth 2003-7
3.9% Spain vs 2.1% EMU



GDP deflator growth 2014-6
0.4% Spain vs 1.1% EMU

Exports/GDP
25.5% in 1Q2008

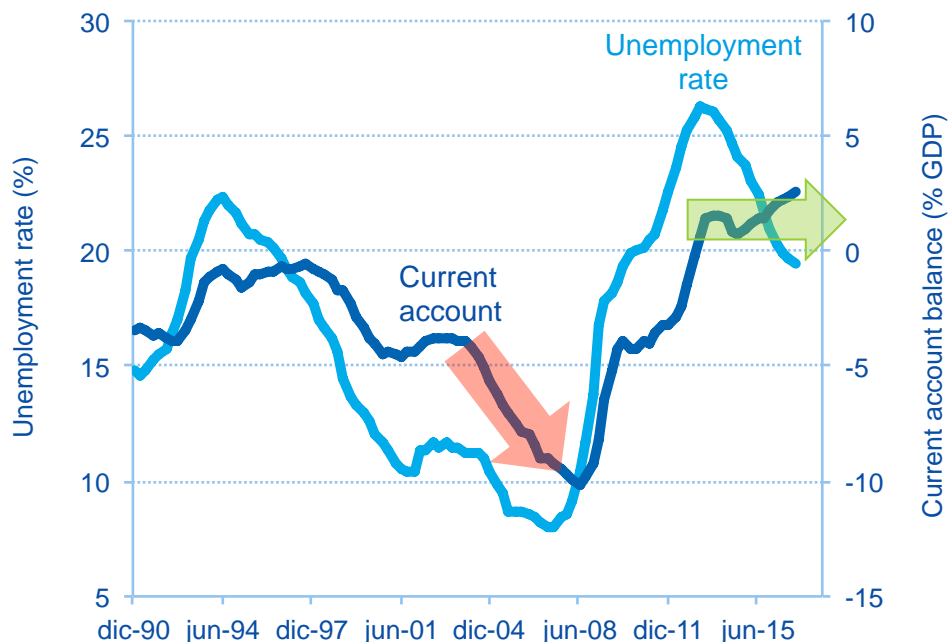


Exports/GDP
33.1% in 2015

Effects of structural reforms on structural unemployment

Spain: current account balance and unemployment rate

Source: BBVA Research



In the past, job creation implied a large deficit in the current account

So far, employment growth is consistent with a current account in surplus

The challenge now is to reduce unemployment without increasing the current account deficit

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Continuing the process of structural reforms to ensure a sustainable and inclusive growth

Regular monitoring and evaluation of the implemented reforms



Redesign and new reforms until the objectives are reached

Continuing the process of structural reforms to ensure a sustainable and inclusive growth

Labour market

- Internal flexibility
- Employment quality
- Long-term U (ALMP)

Competitiveness

- Size of firms
- Exports & regulations
- R&D

Public sector

- Sustainability
- Tax reform
- Efficiency

Long-run factors

- Better education
- Training for workers
- Better institutions

Continuing the process of structural reforms

Labour market: more and better employment

6.7%

of workers under collective agreement at the firm level in 2015



Promote collective bargain and internal flexibility at the firm level
Reduce judicial uncertainty

25.7%

of temporary employment 4Q2015



More incentives to open-ended contracts (e.g., Austrian model)
(see BBVA Research, 2014)

12.9%

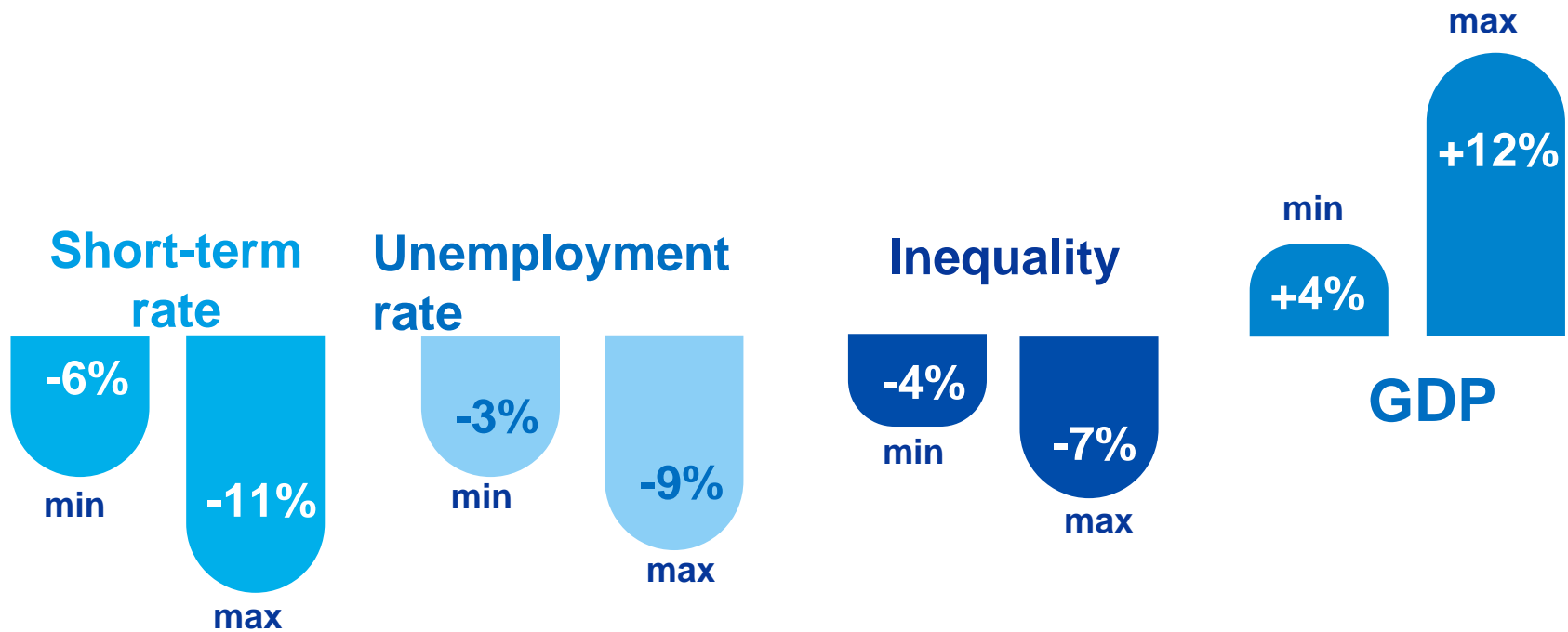
of the labour force has been unemployed for 12 months or more



ALMP and better integration with unemployment benefits to increase job search

Continuing the process of structural reforms

Labour market: more and better employment



Long-term impact of the permanent employment proposal made by BBVA Research and the Sagardoy Foundation

Source: BBVA Research, Box 1 Spain Outlook, 1Q15

Continuing the process of structural reforms

Policies to increase competitiveness

4.7

Workers per firm in 2012 vs 7.7 in EU8 and 19,5 in USA*



Better regulation & business climate
to promote firm growth
Increase efficiency of judicial system

60%

Target share of exports over GDP given by
the pattern of Germany, South Korea, etc.



Better regulation & business climate
to increase internationalization
Competition in intermediate inputs
(Correa and Doménech, 2015)

50%

Average gap in R&D investment with
respect to the EU8



PPPs from institutes specialized in
providing knowledge transfer,
technology and innovations to SMEs

Continuing the process of structural reforms

General government: sustainability and efficiency

-5%

Budget balance over GDP in 2015



Complete the consolidation process
Fight against tax evasion
New finance system for regions

81.1%

Social security contributions over indirect taxes are higher in Spain than in EU8 2011



Fiscal reform: more transparent and efficient system with less distortion
Fiscal devaluation
(Boscá, Ferri and Doménech, 2015)

34.2%

Gap in Government Effectiveness in 2013 with respect the EU8 ([WGI](#))



Complete CORA
Increase efficiency and quality of public spending (new technologies and better management)

Continuing the process of structural reforms

Better human capital and institutions in the long run

21.9% vs 8.8%

Early leavers from education and training in Spain vs EU8, 2014 (% 18-24 years old)



Fight against early school leaving

33.8%

Unemployment rate for workers with less than or lower secondary education in 2014



More efficient vocational education and training programs

19%

Average gap in Indicators of Governance in 2013 with respect the EU8 ([WGI](#))



Increase quality of institutions
Better regulators
More efficient judicial system

Main messages

1. After six years of crisis, Spain is finally recovering due to a **favourable combination of external and domestic factors**
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