

# Assessing the Impact of Product Market Reforms in Spain

Comments to the presentation by Pablo Hernández de Cos, Bank of Spain

**Rafael Doménech**

Assessing Product Market Reforms in Programme and Vulnerable Countries

Brussels, November 25, 2013

## Main results of Hernández de Cos' analysis

- The impact of the **internal devaluation** process on growth and employment **depends** both **on** wage moderation and **the adjustment in price-cost margins**
- Available indicators point to **some progress in terms of PMR** in Spain, but there is room for improvement (page 12)
- Since 2008 the **profit share** in NFCs (GOS/GVA) **has increased over 5 pp**, as in other vulnerable countries. However, this proxy has some pitfalls (capital cost, heterogeneous firms, etc.)
- **Markups** around 1.2 until 2007 then **increased towards 1.3** in 2011. **Higher initial markups and debt ratios** in 2007 explain the change of markups in 57 sectors
- Regional regulation has been reduced with the 2010 Retail Trade Law, but **regulation remains very heterogeneous across regions**
- **Productivity “duality”**: lower productivity than our peer countries for **small firms**, and comparable productivity for **large firms**

## Main results of Hernández de Cos' analysis

- **Main economic policy implications**
  - Signs of **improvements in several dimensions**: retail sector, housing, administrative burden
  - Need to monitor closely **other reforms** such as energy sector, judicial system, professional services, etc.
  - Need to tackle lack of efficiency in business dynamics and to increase **firm size**
- This presentation
  - analyses a crucial factor for employment growth and structural reforms
  - finds very **interesting empirical results**, and
  - offers **sound economic policy recommendations**

# Structure of this presentation

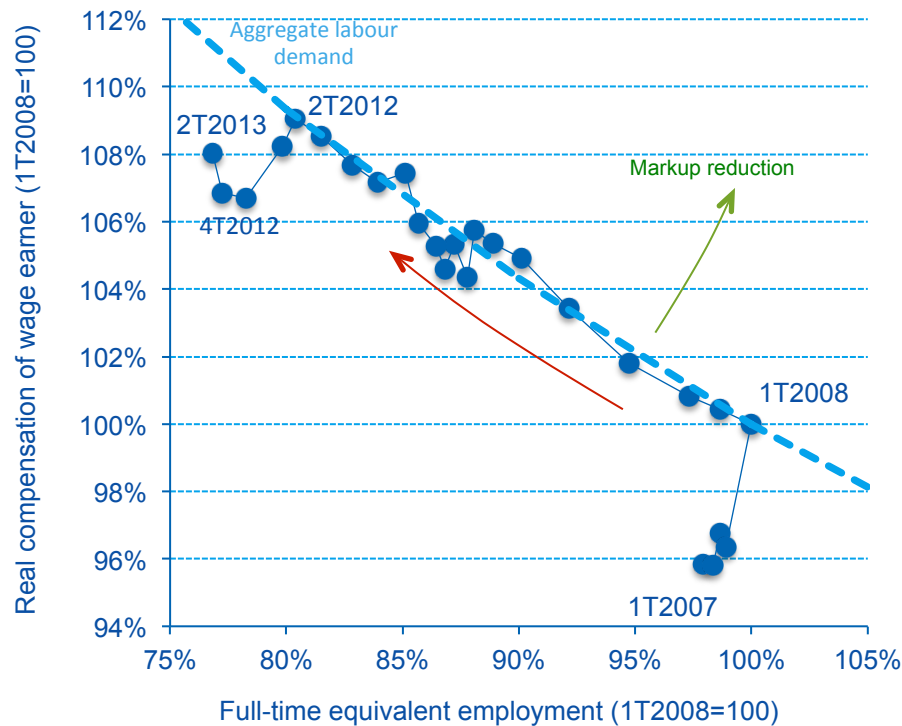
- **Three main comments**
  - Markups and prices
  - Regional implications of product market regulations
  - The effects of PMR on firm size and implications for aggregate productivity
- Other comments
- Concluding remarks

1. Markups and prices

# Markups and aggregate labour demand

## Aggregate labour demand in the private sector, Spain 2007-2013

Source: BBVA Research and Andrés and Doménech (2013)



Employment growth is the most important challenge of the Spanish economy in the short and medium run

Although wage rigidities seem to be the most important factor behind employment destruction (movement along the aggregate labour demand) ...

... other factors as productivity, capital accumulation and markups are important as well ...

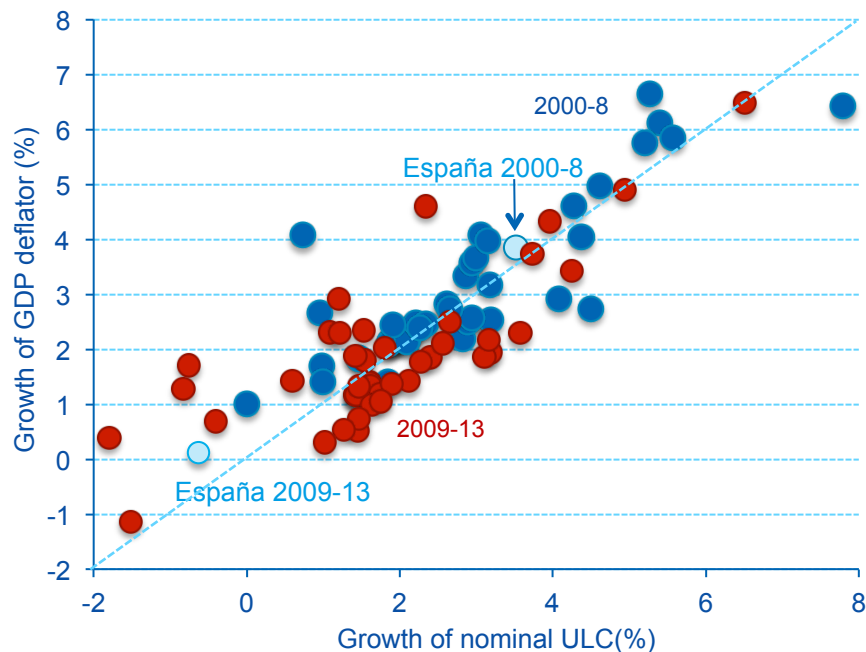
... particularly for successful results of labour market reforms

1. Markups and prices

# Prices and nominal unit labour costs

## Prices and nominal ULC, 2000-8 and 2009-13

Averages of annual growth of GDP deflator and nominal ULC\*  
Source: AMECO and BBVA Research



\* Each point in this graph represents EU27 countries and major advanced economies Included in the AMECO database for 2000-8 (blue) and 2009-13 (red). In Spain unit labour costs from 2009 to 2013 are calculated using compensation per wage earner

In any case, the behaviour of markups does not prevent prices (GDP deflator) to respond to changes in unit labour costs ...

... both in expansions and recessions

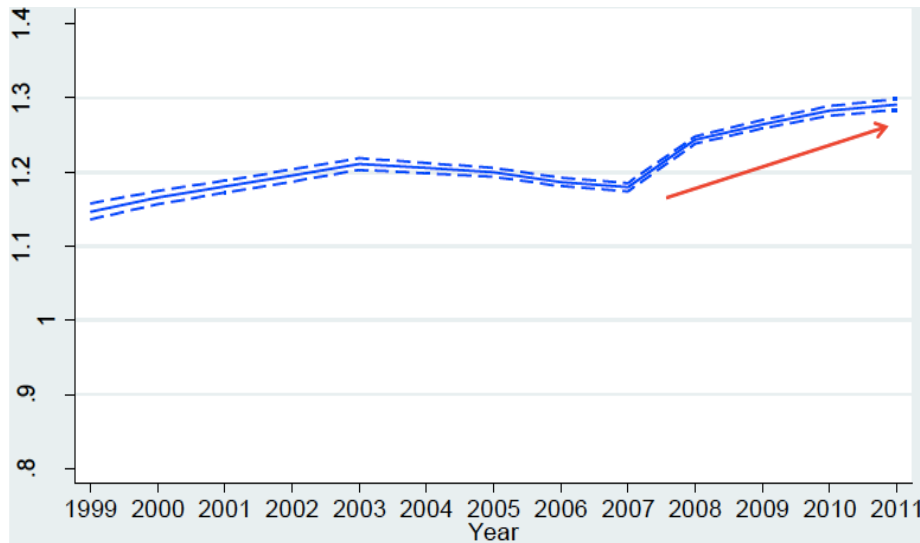
Spanish evidence fits nicely to other advanced economies: inflation falls when nominal ULC growth diminishes

1. Markups and prices

# The behaviour of markups during the crisis

## Rolling regression: estimates of price-cost margin

4-year rolling windows, 10% confidence intervals and GMM estimation  
Source: Hernández de Cos, Bank of Spain (2013)



Initial markups and the selection of efficient firms: Have been the most efficient firms with higher markups the ones that have survived?

Composition effects may be relevant

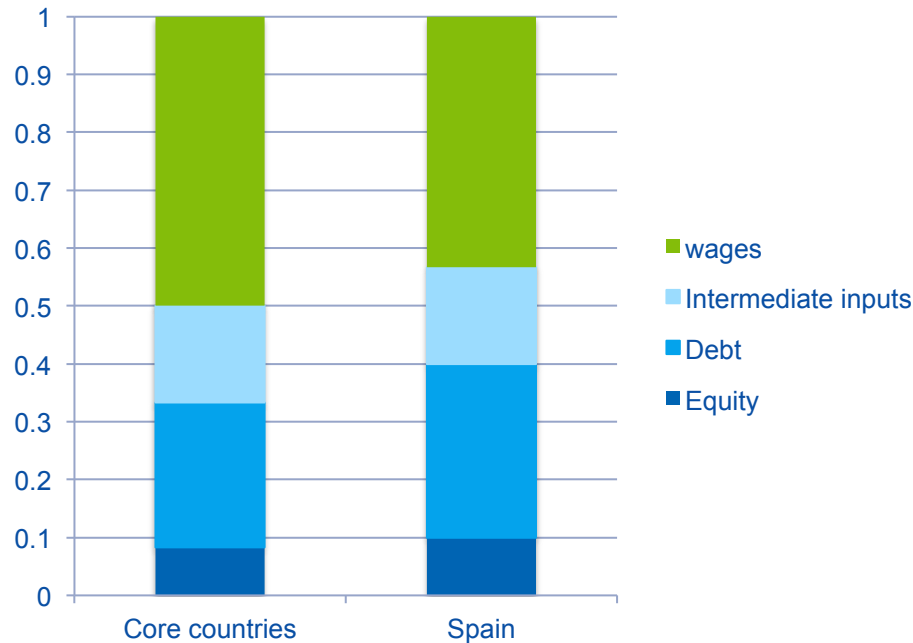
Financial restrictions and financial fragmentation in Europe

1. Markups and prices

# Implications of financial fragmentation in Europe

## Price decomposition

Source: BBVA Research



Assume a tradable good and a common technology, and that the one-price law holds for final goods and intermediate inputs

Under the assumption of free movements of capital ...

... financial fragmentation implies that wages should be lower in countries with higher financial costs

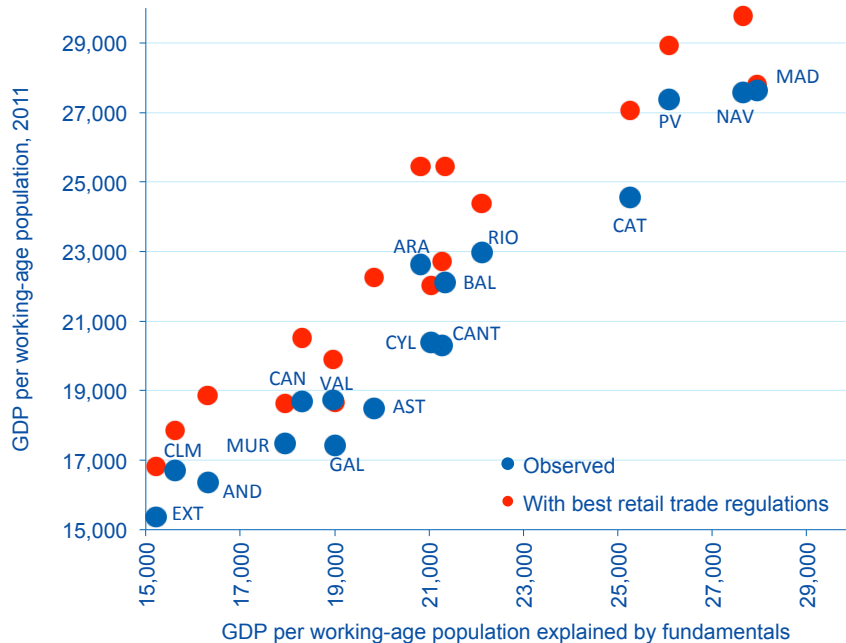


2. Regional implications of product market regulations

# Retail trade regulations and GDP

## The effects of retail trade regulations on GDP per wap

Source: BBVA Research and Think Tank Civismo



Retail trade regulation is one of the factors that helps to explain regional performance

With only two factors (human capital and retail trade regulations) we can explain 95% on regional variance in GDP per working-age population

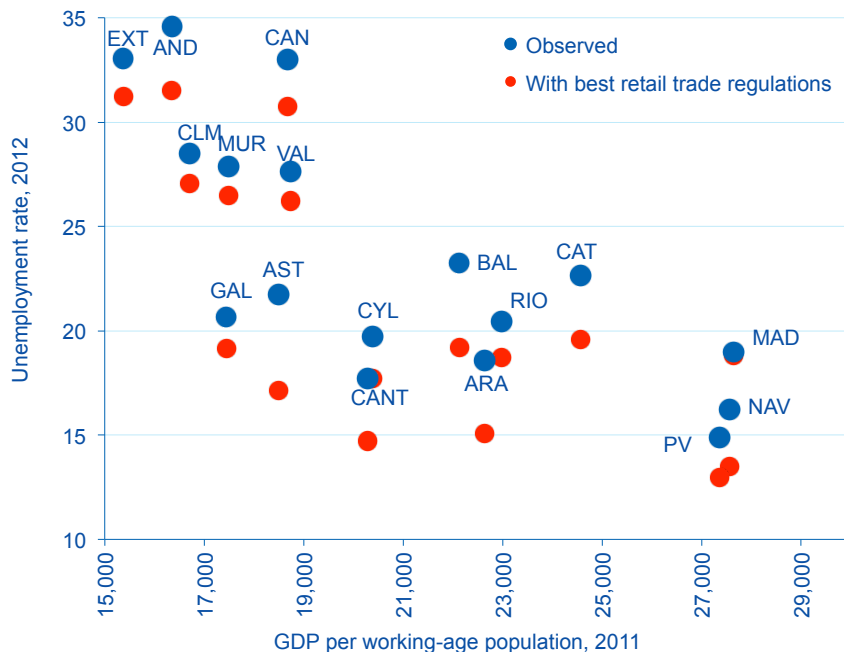
Economic relevance: GDP per wap could be increased 9% on average if other regions improved their retail trade regulations to the level observed in Madrid

2. Regional implications of product market regulations

# Retail trade regulations and unemployment

## The effects of retail trade regulations on unemployment

Source: BBVA Research and Think Tank Civismo



Given a common labour market regulation, differences in productivity explain a large share of differences in unemployment rates (62%)

Through its effects on productivity, retail trade regulations also affect the unemployment rates

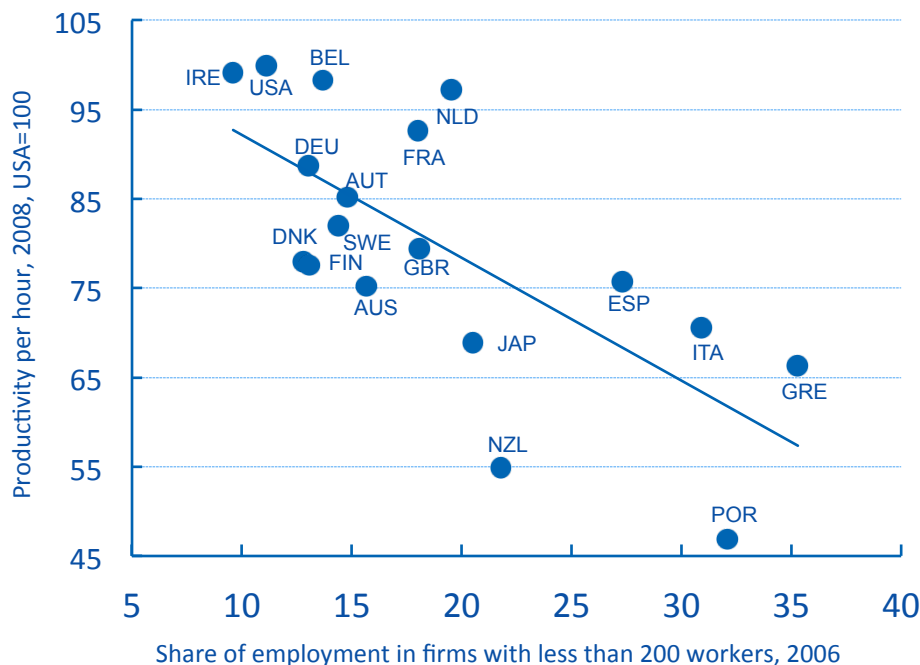
Unemployment rates could be reduced by 4pp on average if other regions improved their retail trade regulations to the level observed in Madrid

3. PMR, firm size and productivity

# Firm size and aggregate productivity

## Firm size and aggregate productivity

Source: BBVA Research and OECD



Firm size is significantly correlated with aggregate labour productivity

Composition effect matters: lower productivity than our peer countries for small firms, and comparable productivity for large firms

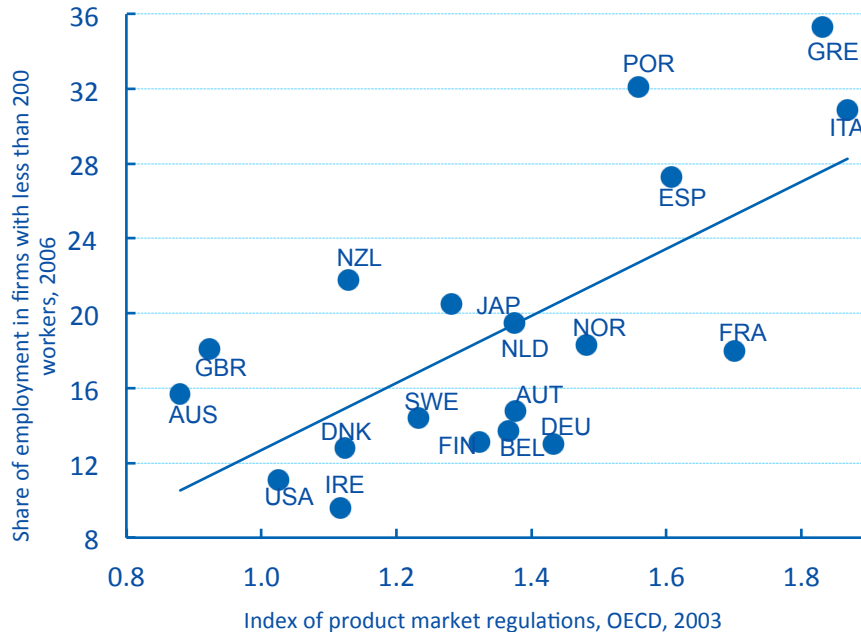
with the firm size distribution of Germany (from micro to large firms), Spain could improve aggregate productivity by 13% (Círculo de Empresarios, 2013)

3. PMR, firm size and productivity

# Product market regulation and firm size

## Product market regulation and firm size

Source: Cuerpo, Doménech and González-Calbet (2011)



Firm size is correlated with product market regulation

Excessive tendency towards size-dependent policies favouring small-sized firms

Policies favouring the creation of small firms should be complemented with policies favouring the increase of firm size (correct incentives)

## 4. Other comments

## Service sector regulation

- As stated by Hernández de Cos, it is important to **identify and correct anti-competitive service sector regulation** on manufacturing
- The literature has shown that **value added, productivity, and export growth** in downstream manufacturing sectors suffer from inadequate service sector regulation
- The service sector regulation that matters most relates to **energy, professional services, transport, distribution networks and telecommunications**
- This has had **important effects within OECD countries** and evidence is still gathering (see Barone and Cingano, *Economic Journal*, 2011)

## 4. Other comments

## Other reforms

- Assessment of the impact of the **new institution** created to monitor competition: Comisión Nacional de los Mercados y la Competencia
- Hernández de Cos concludes that “there has been significant improvement in **red tape**: firms administrative burden and costs of starting a business” ...  
... but **we lack good information on this** and firms still complain about **this burden, which can be reduced significantly**
- **Judicial system efficiency and legal certainty** are also extremely important
- **The Reform of Public Administration (CORA)**
  - Very large effects on the performance of the **private sector**
  - Proposed by the **central government** but its final effects will depend on the **willingness of other administrations** (regional governments) to coordinate and implement the correct measures

## Concluding remarks

- Product market reforms are important **complementary measures** to wage moderation and productivity growth to **improve competitiveness** and to increase **employment creation**
- **Financial restrictions and financial fragmentation** in Europe are relevant factors behind the recent behaviour of markups
- **Retail trade regulation** is one of the factors that helps to explain **regional differences** in labour productivity and unemployment rates
- **Product market regulations** also affect **firm dynamics and size**
- In order to increase **potential growth**, Spain also needs to **improve service sector regulations** imposing best European practices

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