

# Structural Reforms and the Spanish Recovery

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**Spain and Austria Shaping Europe:  
Common Challenges - Distinct Approaches?**

Oesterreichische Nationalbank, Vienna, 11th of May, 2015



## 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 a large list of structural reforms**, in labour and product markets, the financial system or the public sector
3. Thanks to these reforms, current **employment growth is consistent with a balanced recovery**, in contrast with the growth pattern previous to the crisis
4. Given these positive effects, **to ensure a sustainable and inclusive growth** it is key to **continue the process of structural reforms** to reduce structural unemployment, and increase competitiveness of Spanish firms, productivity and quality of employment, human capital and the quality of institutions.

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## Section 1

### **Structural reforms as a driver of the economic recovery**

## Section 2

### Main structural reforms implemented

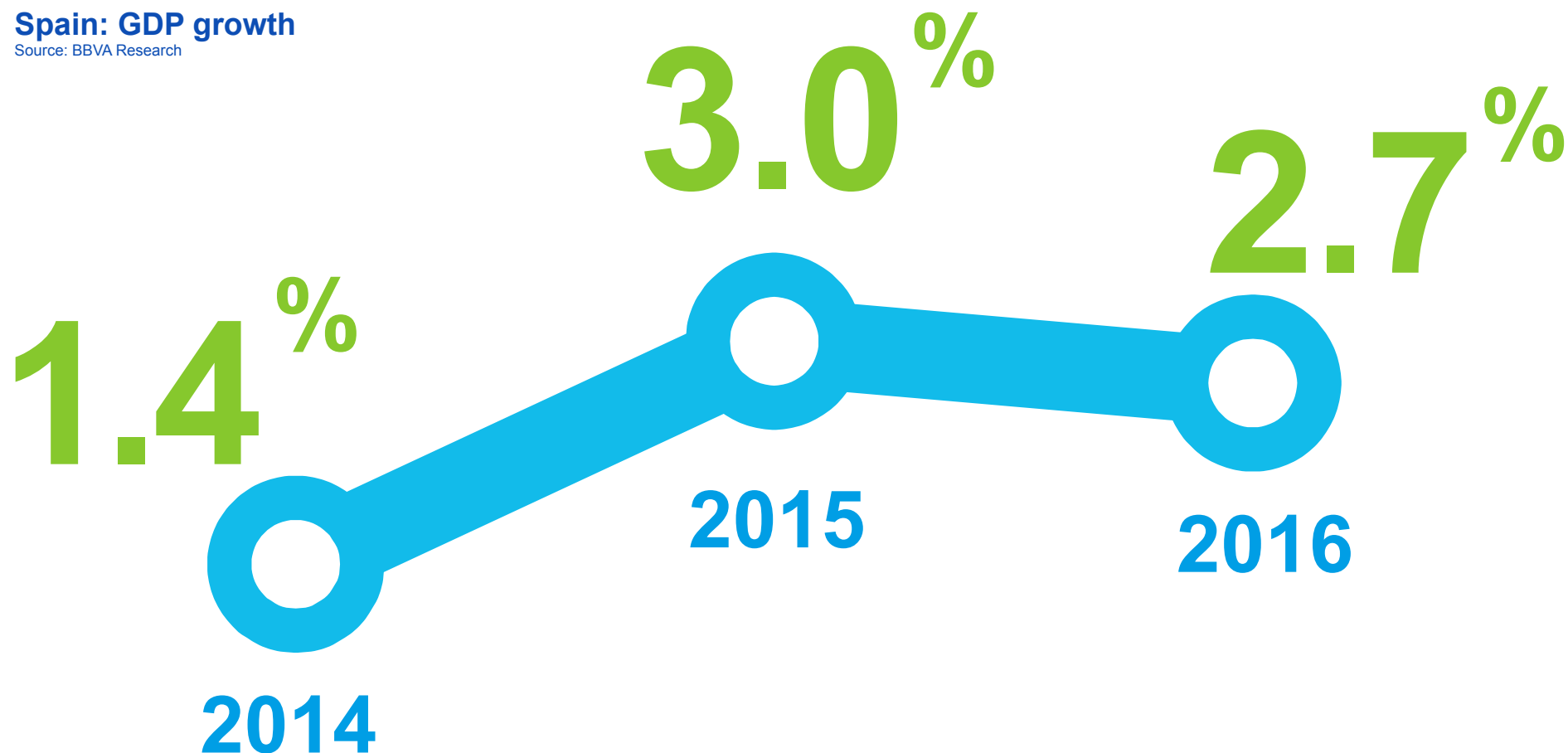
## Section 3

### 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

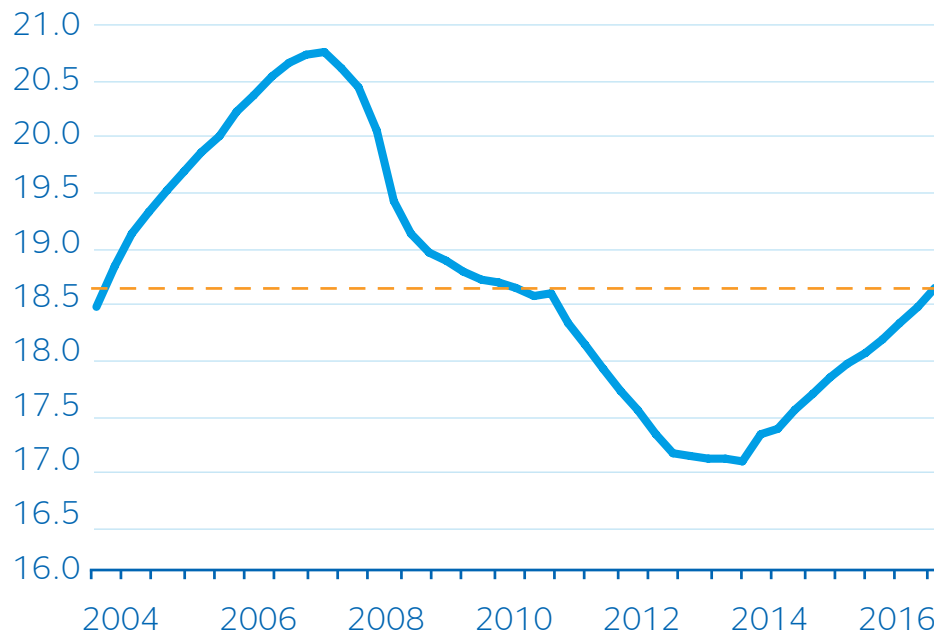




# Spain is finally recovering due to a favourable combination of external and domestic factors

## Spain: Employment (LFS, millions)

Source: BBVA Research based on INE



Between 2015 and 2016 slightly more than one million jobs will be created

By 2016, employment could be back to the 2004 level ,,

... and GDP per capita to the 2008 level

# 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

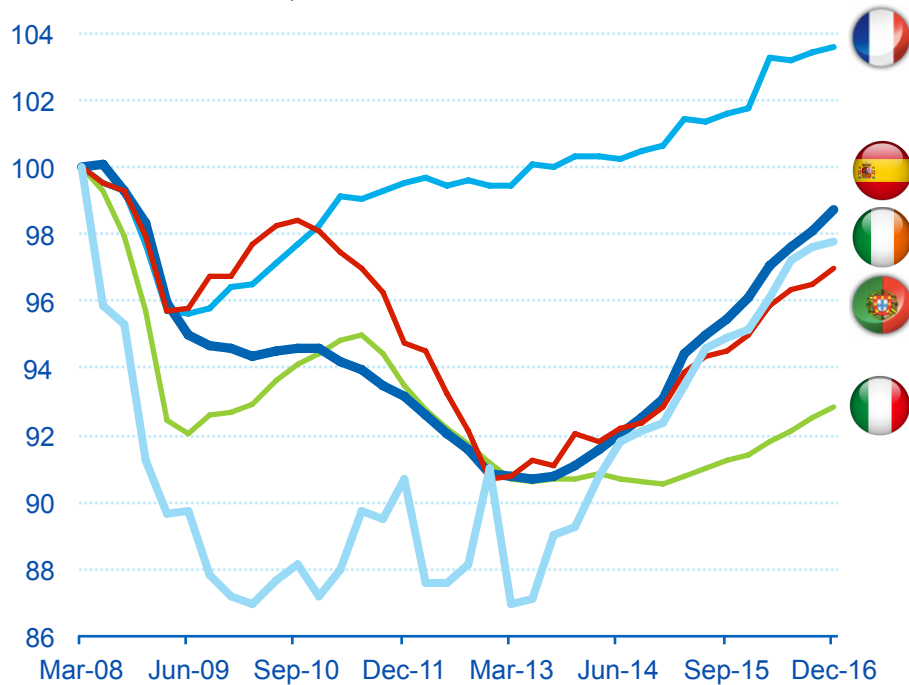
## Domestic factors

- Internal forces of a free market economy
- Structural reforms

# Alternative explanations not supported by the evidence

## 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

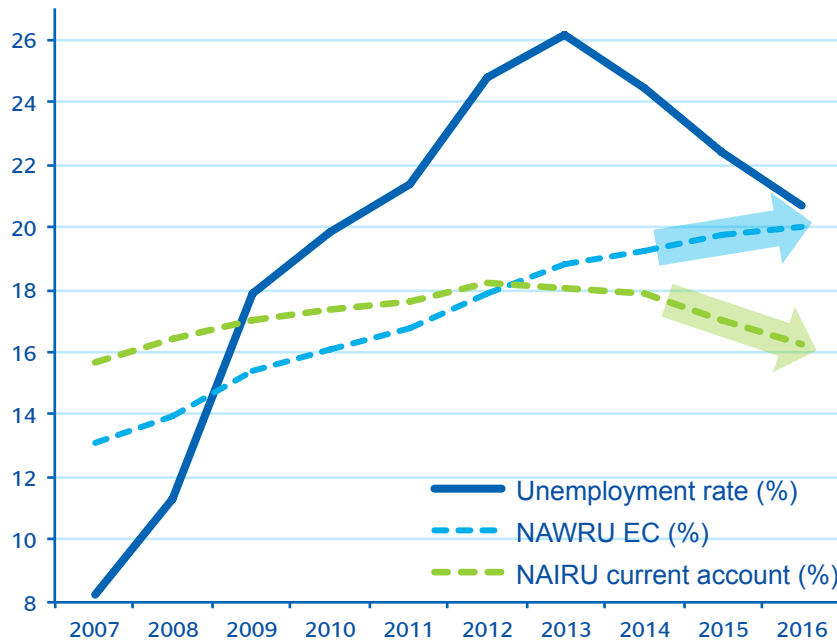
## Uncertainty on the effects of structural reforms

- 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



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

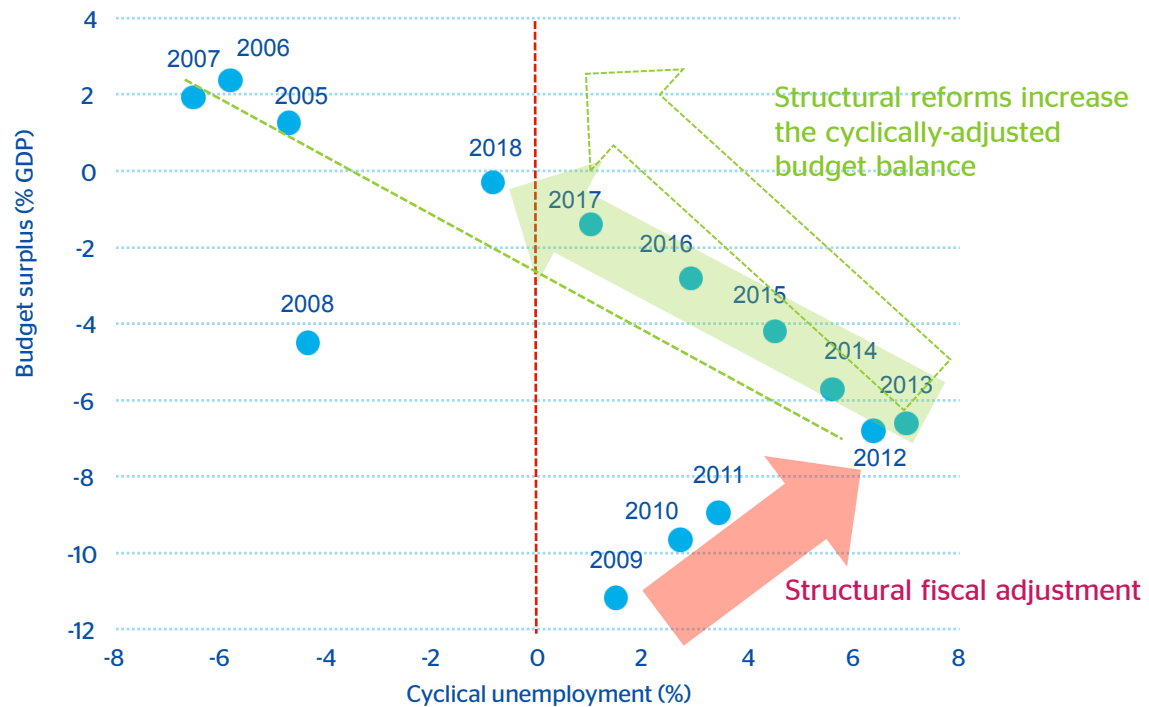
Alternative estimates suggest a decrease after the labour market reform in 2012



# 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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Structural reforms as a driver of the economic recovery

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**Main structural reforms implemented**

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

## Main structural reforms implemented

Labour  
market

Policies  
to foster  
competition

Better public  
finances

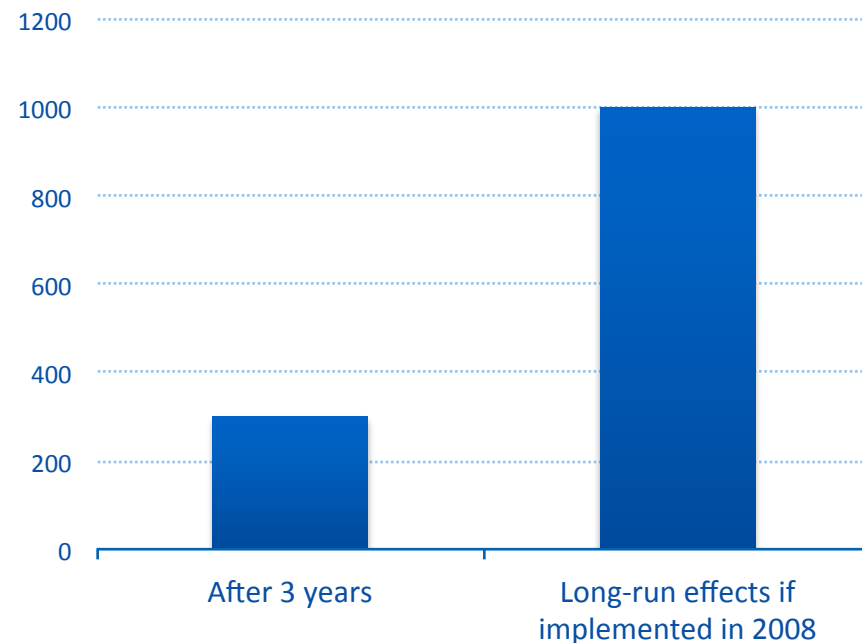
Financial  
sector

# Labour market (1): more internal flexibility

## Spain: effects of wage flexibility and the labour market reform on employment

(Thousands of full-time equivalent jobs)

Source: BBVA Research



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

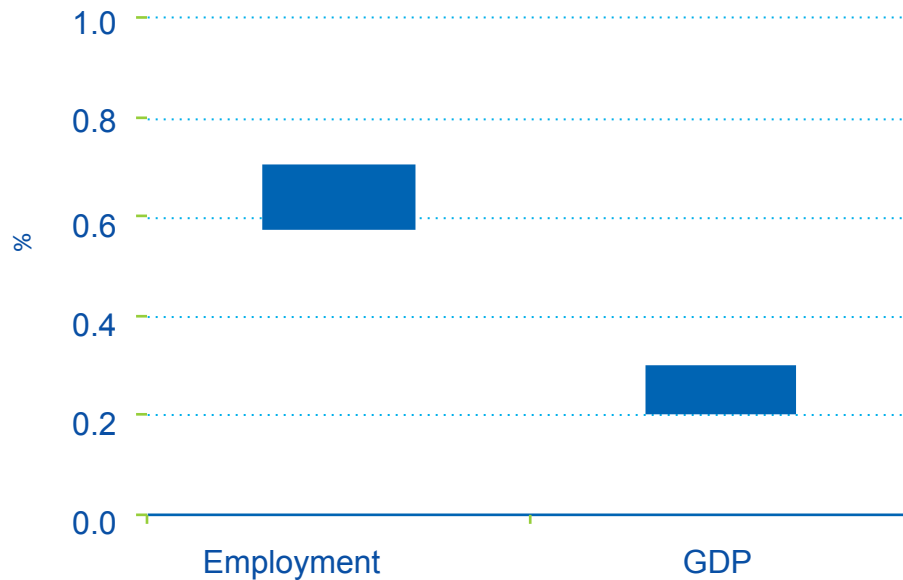
Without the greater wage flexibility of 2012, an additional 220K jobs would have been lost in 2012 and 2013

The implementation of the reform at the beginning of the crisis might have prevented the destruction of around one 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

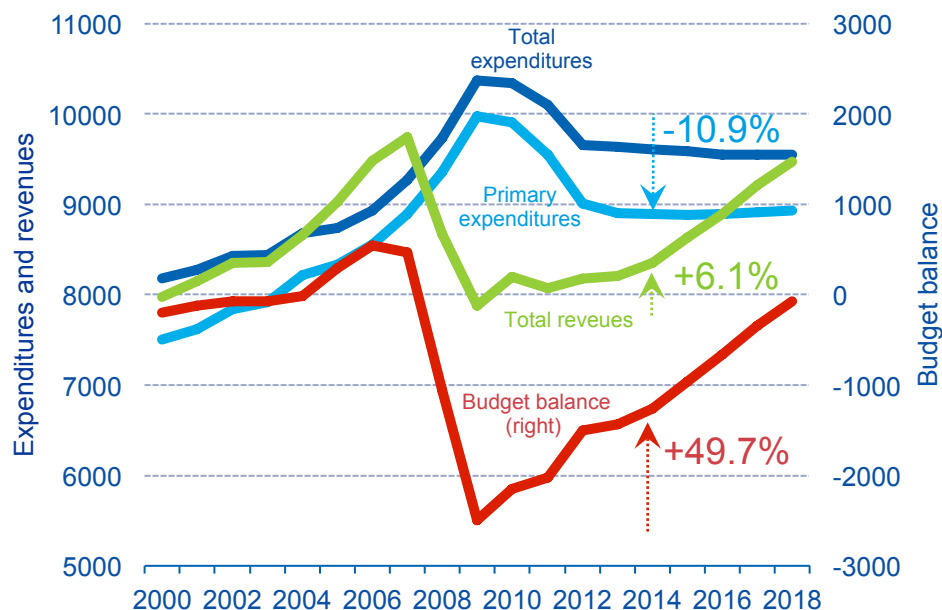
- National youth guarantee system
- Better ALMP (new employment strategy, PPP in intermediation, ...)



# Better public finances (1): fiscal consolidation

## Main public sector aggregates in per capita terms euros of 2013

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



A sizeable fiscal adjustment from 11.2% of GDP in 2009 to 5.7 in 2014: a reduction of 49.7 in per capita terms ...

... that has been the result of a reduction in public expenditures (excluding interests) of 10.9% ...

... and an increase of 6.1% in public revenues, tax rates and tax bases. Fiscal reform in 2015

## 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)

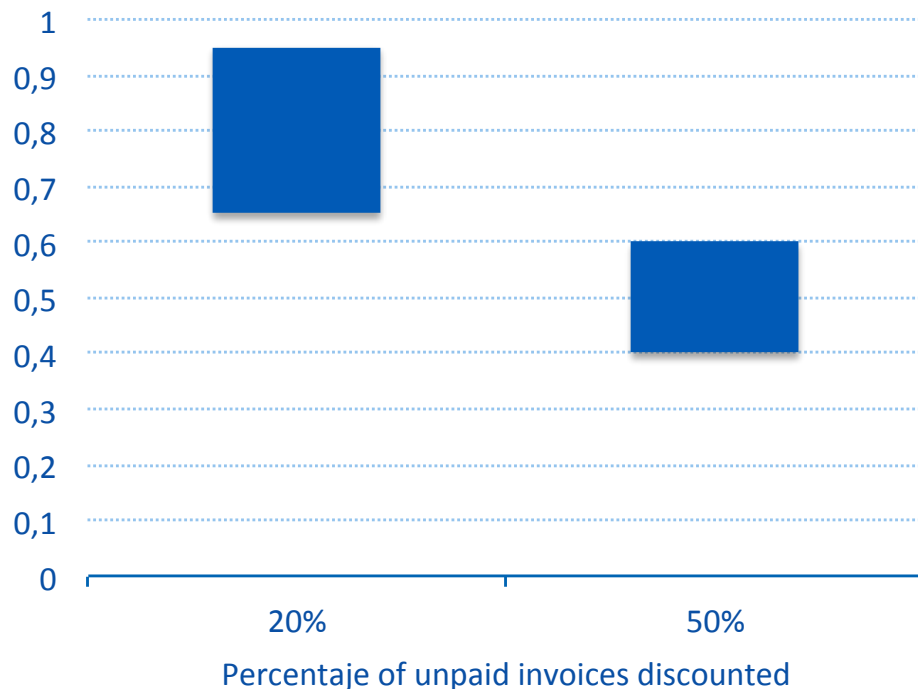


+ Structural revenues  
- Structural expenditures  
- Deficit correction component

# 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: focus on asset valuation

**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

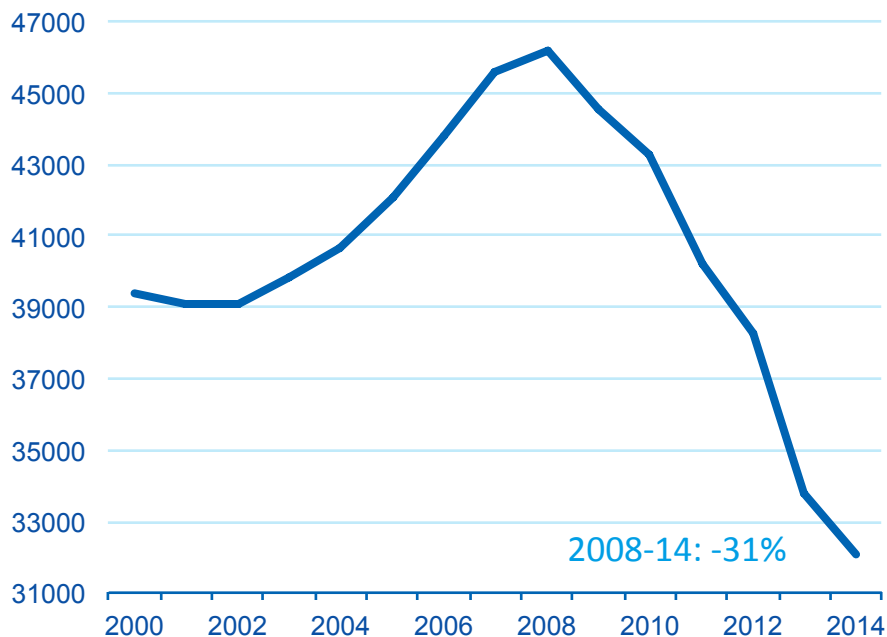
**2014**

Disintermediation and promotion of capital markets for SMEs and venture capital

# Restructuring the financial system (2)

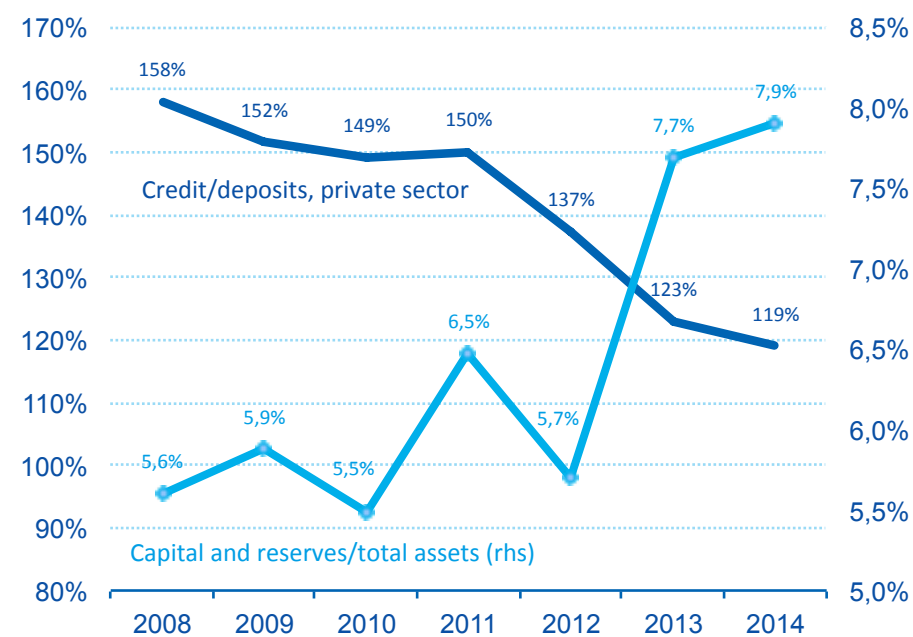
**Number of branches of Spanish banks**

Source: BBVA Research based on Bank of Spain



**Solvency and liquidity of Spanish banks**

Source: BBVA Research based on Bank of Spain

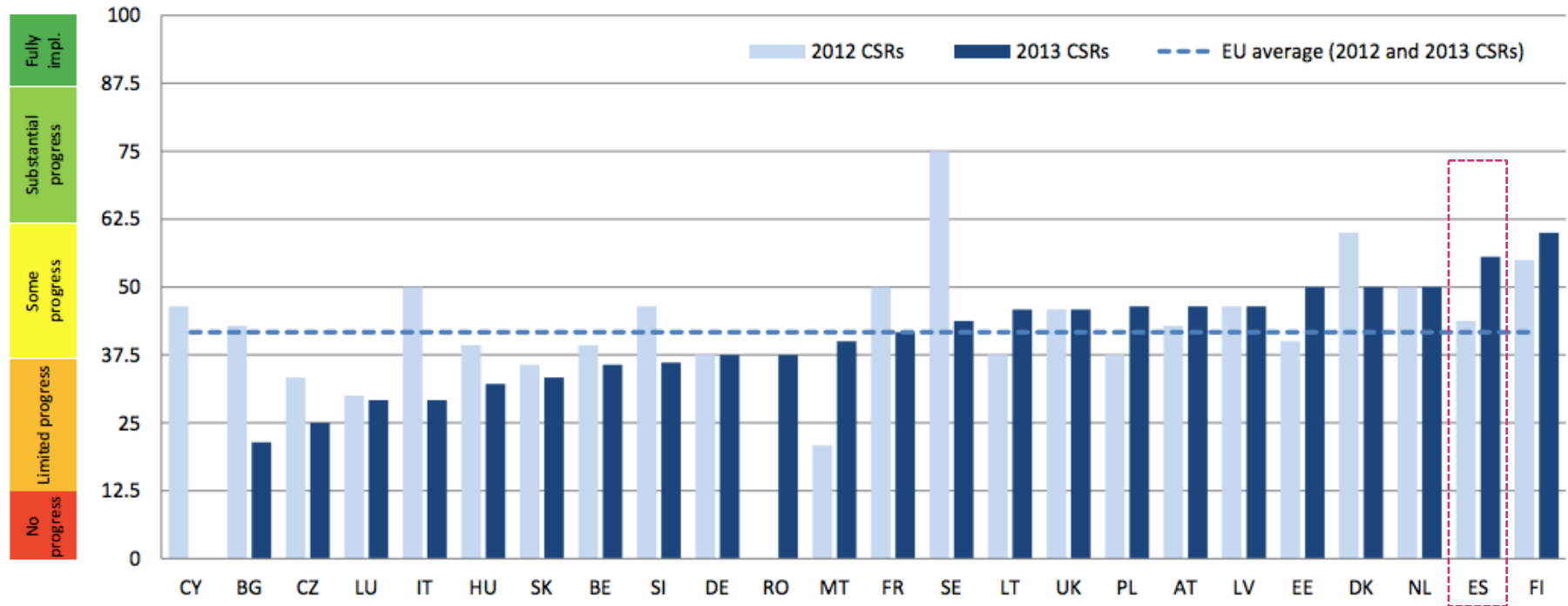


As a result of the restructuring process, the Spanish banking system was the best performer in the 2014 AQR exercise and the third in the stress tests

# 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  
0.2% Spain vs 0.6% EMU

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



GDP deflator growth 2014-6  
0.1% Spain vs 1.1% EMU

Exports/GDP  
25.5% in 1Q2008

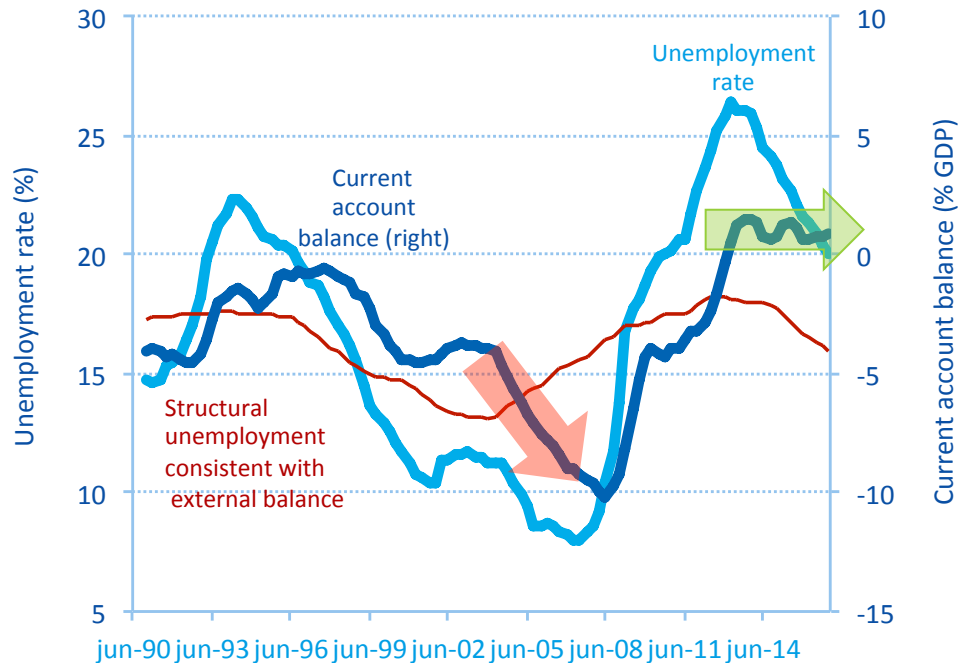


Exports/GDP  
32.4% in 4Q2014

# 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**

# 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
- Quality of contracts
- Long-term unemp.

## Competitiveness

- Size of firms
- Exports
- R&D

## Public sector

- Consolidation
- Tax reform
- Efficiency

## Long run factors

- Better education
- Training
- Institutions

Continuing the process of structural reforms

## Labour market: more and better employment

**7%**

of workers under collective agreement at the firm level



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

**23.6%**

of temporary employment 1Q2015



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

**25%**

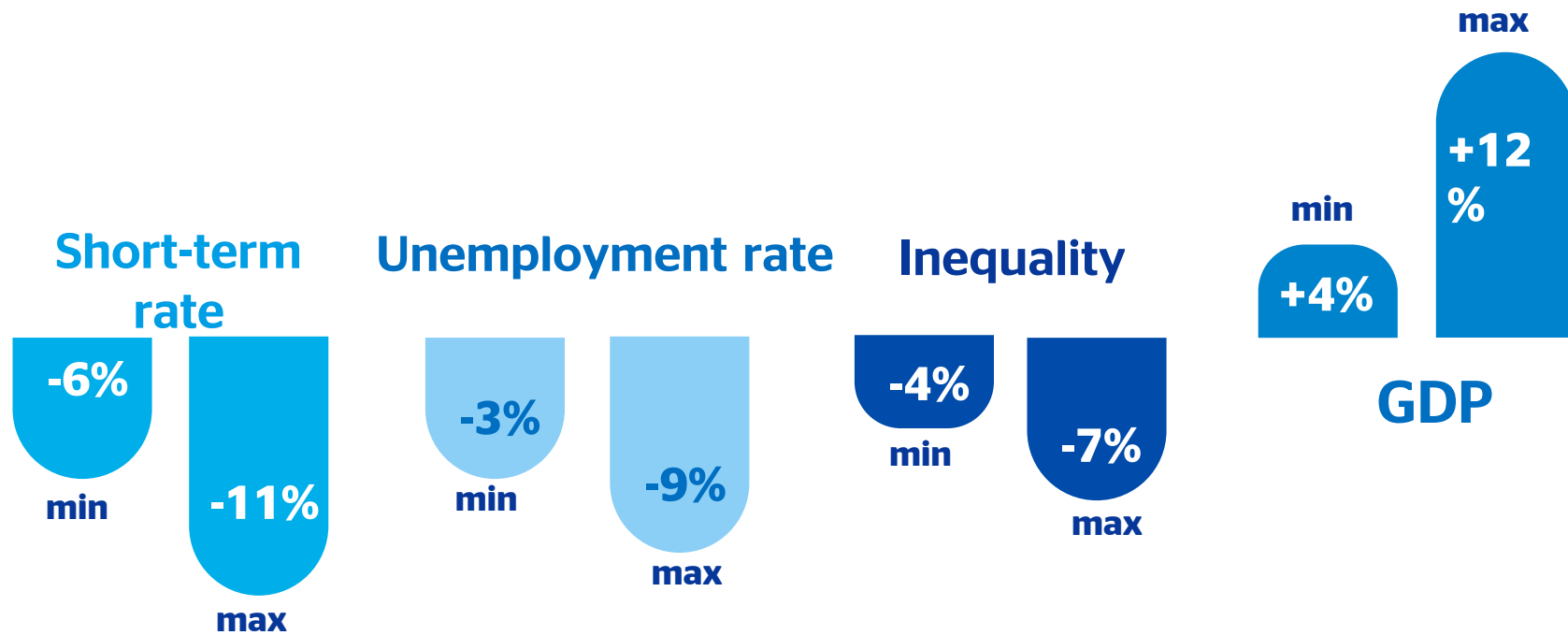
of the unemployed has been jobless for more than 3 years



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



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

**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

**-5.68%**

Budget balance over GDP in 2014



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

**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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