Press Articles

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Economic Analysis

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What are the strengths of Spain?

The answer to the question “how are you doing?” is often “fine… or should I tell you?”. But unfortunately there is usually no time for them to tell us, if the answer is “fine”. What some people “told” us in Spain a few years ago was that not everything was going as well as the growth data seemed to suggest and that chronic deficiencies in our economy needed to be corrected. You already heard about the list of well-identified problems. An analysis of those problems can be found in past and current BBVA Research publications.

And now, how are we doing? Continuing with the above analogy, “not well… but I’ll tell you”. These are not magic wand tales and there are nuances, but there are strengths and positive trends in the Spanish economy; and they will improve if the country focuses on what we know works and changes.

Let us start with the obvious: Spain is doing better. It is true that Spain’s GDP declined in 2009 and stagnated in 2010 and 2011, to fall once again in 2012. However, excluding the sectors that need adjustment –construction, the public sector and financial services– the rest of the economy, which accounts for nearly 70% of GDP, grew at over 2% in 2010 and 2011. These sectors have declined somewhat in 2012, but less than the country’s GDP, partly as a result of extreme financial turbulence.

These economic developments are a result of exports, which are already up 15% on pre-crisis levels and around 25% since the floor registered in 2009. Together with the fall in imports, the foreign sector has increased its contribution to growth: 0.3 percentage points in 2010, 2.3 in 2011 and 2.6 in 2012. And it has managed to reverse the high current account deficit we had. The world is growing, more strongly in the emerging economies, which are becoming an increasingly important destination for our exports; and although most go to our European partners, lower demand is offset by market share gains.

Despite the 20% increase in our unit labor costs compared to the rest of industrialized countries over the last 10 years, some companies have managed to be competitive. And they have done so very well in spite of China’s entry into the international trade arena. During that period Spain has seen its export share reduced by 9%, compared to 40% in France and 12% in Germany, for example. And in some sectors, including legal services, engineering, architecture and marketing, Spain has increased its global market share from 2.5% to 3.2%, which is no small feat.

The fact that some of the companies have gained this share in such an adverse environment can only be explained, in figures, by a commitment to become intensive in technology and human capital, with a much higher proportion of permanent and non-temporary workers, and probably with lower-than-average labor costs. And without figures: thanks to a great adaptation capacity and creativity. These companies have achieved a level of productivity much higher than the rest of the economy, but they are few. Less than 4% of exporting companies account for nearly 90% of the value of total exports.

Their secret is not being in a given sector, because exports in Spain are very diversified, both by type of product and by geographical area. The secret is their size: not being a small company. There are all types of businesses in an economy but, as a whole, in Spain small companies are too small and large and medium-sized companies are relatively few and far between. And size matters because it enables companies to cross a productivity threshold, make the most of economies of scale, make the right investments in technology and export. It is vital not to stand in the way of business creation, and to remove the incentives for companies to remain the way they are and not to grow.

Because we are also starting from a strong position. If we make a map of the degree of complexity (which is greater as the number of countries that can export those products decreases) and connectivity (which is also greater as the capacity to extend exports of what is produced to other sectors increases) of exports, Spain is above the world average in both variables. This is important because under the hypothesis formulated and tested by Ricardo Hausmann, higher levels in both variables are leading indicators of success in globalization. And the growth of middle classes and the need for infrastructures in emerging economies will contribute to bring the demand in those areas even closer to the pattern of Spanish exports.

But there is a limit to these improvements unless the price structure is changed. Had it not been for the impact of higher export prices, the world share of Spanish products could have even increased and not lost that 9%.

But we are not doing badly either. Since 2008, only Ireland has been able to cut unit labor costs more quickly than the 5% that has been corrected in Spain, while in France and Germany they rose by more than 10%. And this is the result of a strong increase in productivity: 12%, which in some sectors like industry and manufacturing has exceeded 20%.

The rest of the economy will have to continue adjusting, which is not incompatible with growth. The public sector needs to continue moving toward a structural balance to remove the uncertainty surrounding the pace of debt reduction when the economy grows. And in the future, it needs to adapt its spending and tax structure to move toward the new type of growth we are heading for, with a lower weight of consumption than before, and toward a taxation model that generates a more favorable atmosphere for job creation.

Secondly, the financial system reform, which is already at a very advanced stage, needs to be completed. This is vital for consolidating growth through the granting of credit to companies. And doing this is compatible with reducing debt in the part of the private sector that is overindebted, such as the real estate sector. And with getting credit flowing to companies with a future, which can be made easier by implementing the right measures for lending to SMEs.

But overall, the process for adjusting the external and tax imbalances, which weighed heavily on investors, is making good progress.

Lastly, what we do not see. The labor market. The tragedy of unemployment. Over the last 30 years we have lived with a dysfunctional labor market, where every bad cycle resulted in unemployment rates of over 20%. Well, the 2012 labor reform is moving in the right direction to solve some of the problems: the lack of flexibility in wage negotiations according to the company's conditions, and the high redundancy costs for a privileged part of the workers, which makes it more difficult for new workers to enter the labor market with permanent contracts.

We estimate that the employment rate in the medium term will be around 10% higher than it would be without the reform. Moreover, we estimate that the impact of wage restraint in Spain, which has only taken place starting in 2012, despite the fact that the crisis began in 2008, has avoided the loss of 60,000 jobs in the short term, and this wage moderation would have avoided the loss of one million jobs had it started in 2008.

More needs to be done: generate active employment policies, increase the incentives for hiring permanent employees and provide training for workers in the companies, doing whatever it takes to reduce the strong duality between permanent and temporary workers. And let there be no mistake: for these measures to be truly effective it is essential to increase competition in closed sectors and make it easier to set up new companies, removing barriers.

But going back to the beginning, neither was it realistic to believe that in the past Spain could grow at 3% forever, nor is it realistic to believe today that Spain is incapable of returning to growth rates of over 2%. The match does not end until the final whistle. And Europe must be the final goal. We Europeans need and deserve to continue moving decidedly toward a stronger and more integrated Europe.