

No gain without pain

Diario Expansión (Spain)

Miguel Cardoso

07 May 2018

Dan Ariely, a specialist in behavioural economy, mentions how a personal experience (third degree burns on 70% of his body), led him to seek an answer to what people unfortunate enough to have to contend with pain “prefer”: a short but intense period of suffering, or less pain but for longer. Something similar applies to the famous “structural reforms”, since they usually involve a transfer of income that leads to the groups negatively affected mobilising to prevent them. Governments then have to decide how to manage that pain and at what point in the cycle: with a large number of measures concentrated into a short time-span, perhaps taking advantage of the mandate afforded by a crisis, or taking small steps, tackling the consequences one after the other and taking advantage of an expansive cycle to smooth the transition.

It is said that a crisis is something that should not be wasted. In fact, the evidence points to one of the factors necessary for reforms to succeed being the existence of a clear mandate from society to implement them, and in a crisis the likelihood of such a mandate’s existing is normally greater. This is partly what made it possible to push through a large number of measures in Spain in the recent past to reduce the imbalances that had built up before and after the crisis. One of the keys to smoothing the high costs of implementing these policies was to stress measures that contributed to a more efficient adjustment in the labour market (avoiding greater job destruction), limited the short-term adjustments to the public accounts (emphasising medium-term sustainability, for example reforming the pensions system), and allowed monetary policy to have a greater impact than in other comparable countries (restructuring of the Spanish financial system).

In any case, many of the measures that the country needs were proposed, and the continuity of some of those that were approved is now threatened. In certain cases it is possible to find justification for their delay. For example, reducing labour market duality may require reducing the gap in cost of dismissal between temporary and indefinite employment contracts. However, doing this might have increased job destruction in a crisis environment. On the other hand there is a striking lack of progress towards greater competition in the domestic market. This could be justified by the fear that existed at the time of the possibility of the country’s slipping into a vicious circle of deflation and falling demand, which could have been exacerbated if the reforms had squeezed businesses’ margins even more.

However, Spain’s experience seems to be more in line with theories showing that the policies that potentially boost future productivity may have short-term positive effects (reducing the risk of deflation). In the absence of a crisis that grants a mandate, the Government must win the support of society by clearly explaining these benefits and take advantage of the fact that the recovery will reduce the costs to the groups affected by the measures that are still needed. Such is the case of the reforms designed to bring about a more inclusive recovery and to prepare workers for the challenge posed by technological change (reduction of temporary contracts, improvement of active and passive employment policies) and the push towards an economy with more competition to reduce the level and the growth of margins in certain key sectors for the competitiveness of the Spanish economy (promoting the independence of the regulators, Professional Services Act). Furthermore, now is the time to reduce public debt with a view to accumulating more fiscal space with which to confront less favourable environments. The saying “no gain without pain” is not always true but in the case of reforms it sometimes is. Success may consist in taking advantage of the right moment

to do what is still necessary and standing firm when conditions change as opposed to turning back on the path already trodden. In any case, fluid communication is essential in order to explain the reasons for the measures and their benefits to society.

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance. This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.