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Abstract

Between the first quarter of 1998 and the fourth quarter of 2007 the real growth of the Spanish economy was outstanding, averaging an annual growth rate of 3.7 per cent. This compares favorably with the big five European Union economies and is second only to the truly miraculous growth of Ireland's real GDP. However, the future growth of Spain will depend on many factors. When we look into the crystal ball of the economic future of Spain, two elasticities emerge that will surely make a large difference for its future growth: the consumption elasticity of imports and the output elasticity of employment.

Key-words

Elasticity, Employment, Real GDP, Growth, Labor Market Reform

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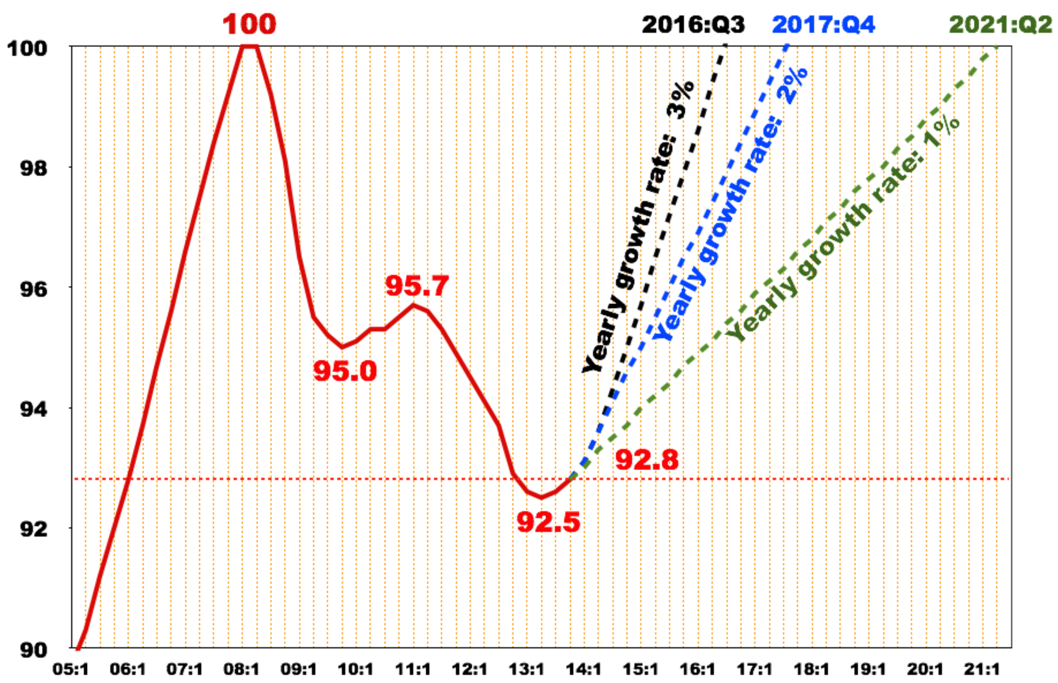
Between the first quarter of 1998 and the fourth quarter of 2007 the real growth of the Spanish economy was outstanding, averaging an annual growth rate of 3.7 per cent. This compares favorably with the big five European Union economies and is second only to the truly miraculous growth of Ireland's real GDP which grew by almost 6 per cent annually in the same period. A construction boom fueled by exceptionally low funding costs following the introduction of the Euro and a large inflow of immigrants largely drove the Spanish economy.

In early 2008 the world-wide financial crisis put a stop to Spanish growth and the period since has been marked by a douple-dip recession leaving present real GDP well below its previous high. This note addresses the outlook for Spain.

The fourth quarter of 2013 was a great quarter for the Spanish economy as far as its growth performance is concerned. The annualized quarterly growth rate of real GDP was 1.2 percent. In the figure we have plotted an index of Spanish real GDP and three potential future scenarios of 1, 2, and 3 per cent growth rates, respectively from 2014 onwards. The plot shows the first quarter in which Spanish real GDP will return to its historical maximum for each scenario.

Figure 1, Yearly Growth Rate of GDP.



If Spanish real GDP were to grow at an uninterrupted and constant rate of 1 percent, it would reach its historical maximum in the second quarter of 2021, 13 years and one quarter after the recession began. If this growth rate were to reach a constant value of 2 percent, Spanish real GDP would return to its historical maximum in the fourth quarter of 2017 and, if it were to reach 3 percent, in the third quarter of 2016. Nobody in Spain in the beginning of 2014 would even dream of 3 percent, and we conjecture that many Spaniards would gladly take anything between 1 and 2 percent. If this were to happen, it will have taken Spain real GDP between 9 and 12 years to reach its previous high. However, the ride is likely to be bumpy and Spanish real GDP may very well take further dips, delaying the return to the pre-recession level further.

The future growth of Spain will depend on many factors. First and foremost, Spanish growth will depend on any and all future reforms and policy measures, which the present and future Spanish governments may take. Unfortunately, the reform plans of the current government are a carefully guarded secret and they are, therefore, hard to comment on. Secondly, Spanish growth will depend on the economic performance of the Eurozone countries and of the rest of the world economy, and this, too, is a big unknown. This said, when we look into the crystal ball of the economic future of Spain, two elasticities emerge that will surely make a large difference for its future growth: the consumption elasticity of imports and the output elasticity of employment.

The consumption elasticity of imports

The first elasticity that will determine the size of the future growth of Spain is the consumption elasticity of imports. The return to growth of the Spanish economy so far has been based on the growth of net exports. Net exports have grown both because exports have grown and because imports have shrunk. In the decade of the boom, the Spanish consumption elasticity of imports was very high (between 1998 and 2008 private consumption grew by 45 percent and imports grew by 118 percent). Since the GDP share of private consumption is, approximately, twice the size as the GDP share of imports, each percentage point of imports growth detracts from Spanish GDP growth half the amount added by each percentage point of consumption growth. This means that, between 1998 and 2008, the net contribution to growth of consumption plus imports was *negative.*

Clearly, at the beginning of 2014 the Spanish economic environment is very different from the Spanish economic environment in 2008. In the six years that have ensued, unit labor costs have fallen, and Spanish firms have become more competitive and they have displaced foreign firms in many export markets. But we still do not know whether this will be the case in the Spanish domestic market, once consumption growth returns in earnest.

If the Spanish consumption elasticity of imports remains high, the growth of imports will slow down GDP growth. If, in the new Spain, this elasticity is smaller, both consumption and net exports will become the engines for future Spanish GDP growth. Unfortunately, expenditure data from the third quarter of 2013 suggest that Spanish imports are growing strongly again. If consumption growth resumes in the next few quarters, we will know whether this early data signals that Spaniards are returning to their old expenditure habits, or whether the expenditure pattern of the new Spain will turn out to be more friendly towards growth.

The output elasticity of employment

With more than a quarter of the Spanish labor force unemployed it is crucial that any economic growth translates into gains in employment. Traditionally, Spain has had short-lived recessions and very high firing costs. The optimal response to these two circumstances is to hoard labor. So much so, that a folk theorem much favored by many commentators and by the Spanish media claims that Spain only creates net employment when its GDP starts growing at 2 percent or more. As a 2 per cent growth might be several years into the future, this leaves little hope for coming reductions in the unemployment rate. However, though it is difficult to tell whether there has been anything to this 2 per cent rule of thumb, there are reasons to think that this time it might very well be different.

The recession that started in the first quarter of 2008 has been the deepest and longest recession in the last 30 years. And since 2010, two labor market reforms have reduced statutory firing costs at least somewhat. These two changes suggest that labor hoarding in Spain is most likely at an all-time low. The firms that have survived the recession most probably have shed all their surplus labor by now, and have adjusted their labor force to a shrinking market. If this were the case, we might see net jobs being created with even minimal growth. If this is what ends up happening, job creation will accelerate the growth of private consumption, and the growth of consumption will accelerate the growth of GDP and contribute to make the growth process self-sustained.

The growth of employment in Spain will be crucial, especially in the light of the rigid nature of the Spanish labor markets as laid out in the following.

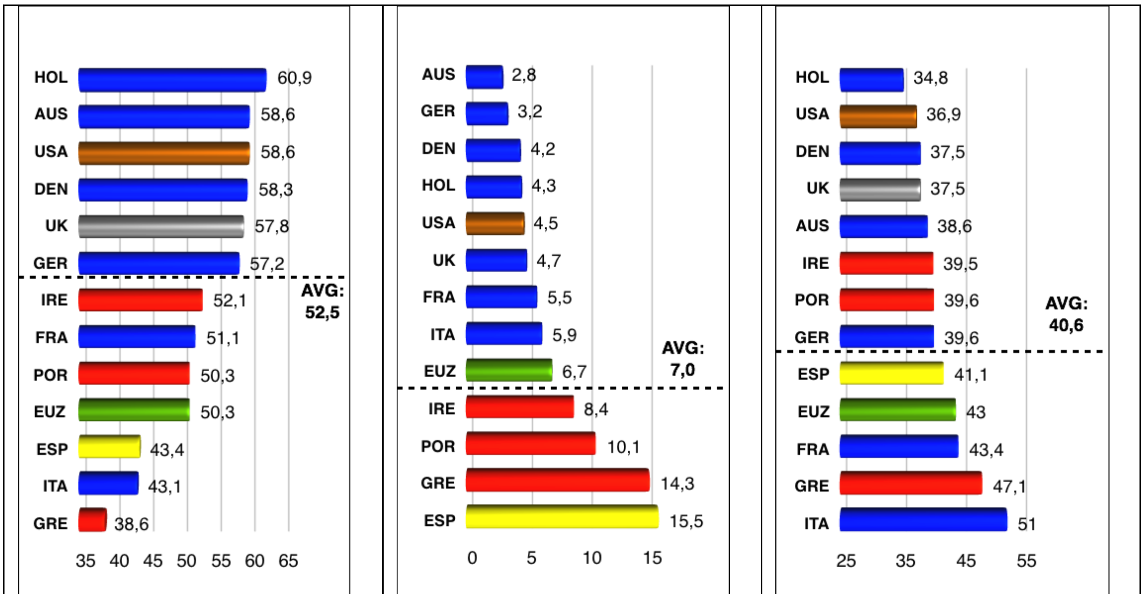
Few Spaniards work, but many look for jobs

Labor market surveys in most places are constructed following the guidelines of the International Labor Organization (ILO), they ask similar questions and they give results that are very comparable. They classify people of 16 years or older in three categories: employed, unemployed, and non-participants. The employed are people who have been in paid employment for at least one hour during the reference week. The unemployed are people who have not been employed but have searched actively for a job during the month before the interview and are available to start working in less than two weeks after the interview. The non-participants are the rest. Figure 2 illustrates the answers to the employment surveys conducted in a selected group of European Union countries, in the Eurozone, and in the United States in the second quarter of 2013.[1]

In Panel A, we report the employment rates. Holland tops the table with an employment rate of almost 61 per cent of its working-age population. The most employment friendly of the European countries and the United States all have employment rates above 57 percent. In contrast, Spain, with an employment rate of 43 percent, is almost 10 points below the sample average, and it is only better off than Italy and Greece.[2]

In Panel, B we report the share of the working-age people represented by the unemployed. In this category the performance of Spain is dismal. It is in the bottom of the sample. Its share of unemployed people (16 percent) is more than twice that of the sample average (7 percent). Immediately above Spain we find the three Eurozone countries that have been granted a full bail-out program. In contrast, the Northern Euopean countries top the table with unemployment shares below 5 percent.

Figure 2: Employment Survey Categories in 2013:Q2 (shares of over-16 year old people)



A: Employed (%)	B: Unemployed (%)	Non-participants (%)

Finally, in Panel C we report the share of the working-age people represented by the labor-market non-participants. Interestingly, Spain, with a share of non-participants of 41 percent is only four tenths of one percent below the sample average, 6 percentage points below the best performer, which is Holland, and 10 percentage points above the worst performer, which is Italy.

According to these data, Spaniards would like to work almost as much as the citizens in the Northern European countries, but they seem to be incapable of finding job openings that they like. If the purpose of the 2012 labor market reform was to approximate the Spanish labor market composition to that of the Eurozone average, it has patently failed to do so in two out of these three dimensions – at least so far. Spain still needs to create some 3.8

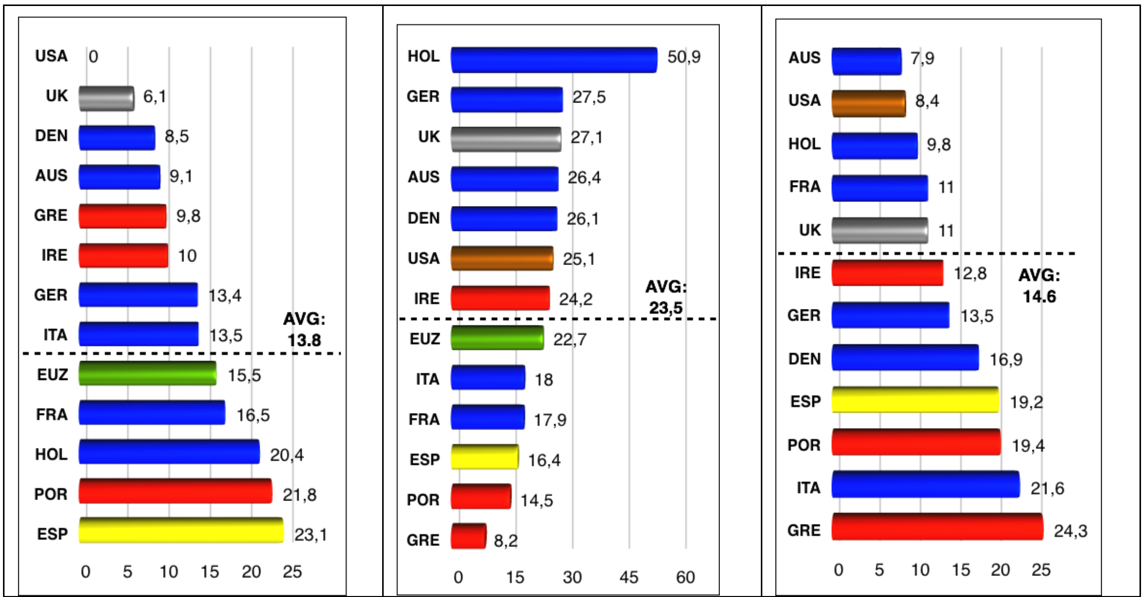
million jobs if it is to move 10 percent of its working-age people out of unemployment and into employment, in order to normalize its labor market shares.[3]

Many Spaniards hold temporary jobs, few work part-time and many work underground

But perhaps the main objective of the Spanish labor market reform was to improve the quality of employment and not its quantity. Before the reform, Spain had a notoriously dual labor market, with firing costs that differed widely between permanent workers -45 days or better per year of employment- and temporary workers —12 days at best. Moreover, Spain had only a very small fraction of part-time jobs, which is strange given the size and labor-intensity of its service sector. Finally, according to Schneider's estimates (2012), in 2012 Spain had a large underground economy which accounted for approximately 20 percent of its Gross Domestic Product (GDP).[4]

To find out whether these three quality indicators have improved, in Figure 3 we compare the Spanish data with those for the countries in our sample in the second quarter of 2013. In that quarter, Spain still topped the temporary employment ranking, with 23 percent of its labor force holding labor contracts that will have to be renewed after three years at most. This share is 9 percentage points bigger than the sample average and 17 percentage points bigger than the best European performer, the United Kingdom (see Panel A).

Figure 3: Types of Employment in 2013:Q2



A: Temporary (%)	B: Part-time (%)	C: Underground (%)

Moreover, Spain's share of part-time employment (16 percent) remains close to the bottom of the list. It is 35 percentage points lower than Holland's stellar performance, 7 points smaller than the sample average, and it is only larger than the shares of Portugal and Greece (see Panel B). Finally, in 2012 Spain's underground employment was still relatively large. It was more than 4 percentage points larger than the sample average, more than 11 points larger than the share in Austria -which was the top performer- and it was only smaller than the underground economies of Portugal, Italy and, once again, Greece.

These three statistics confirm that, in the second quarter of 2013, the Spanish labor market was still severely fractured, as well as that Spanish employers still pursued flexibility using the three margins with the worst incentives and collateral effects: temporary contracts, overtime, and hiring and doing business underground. The exceptionally large share of temporary contracts also implies that the quality of jobs and employment protection are very unequally distributed in Spain and the small share of part-time employment indicates that there remain large fixed costs to forming labor relations in Spain.

Summing up, Spain is below the sample average in all of the six labor market statistics that we reported here. It is far below the average in five of them, and slightly below the average in only one. Thus, we would be hard put to conclude that the reform has been a success. Our data confirms that much more remains to be done before the Spanish labor market starts to resemble the Eurozone average, let alone those of the best performers.

Other changes brought about by the labor market reform

It is true that the 2012 labor market reform has enacted other changes that are more subtle. It has ended with the perverse automatic extension of collective bargaining agreements in the absence of new ones. It has made it easier for companies to side-step the national, regional or sectoral agreements with firm-level agreements of their own. And it has made it easier for employers to redefine tasks, displace their employees and reorganize their workforce. All these changes have clearly increased the degrees of freedom of employers. But it is also true that the unprecedented amount of job destruction brought about by the recession, with more than 6 million unemployed at its very worst, has weakened the bargaining position of workers and trade unions alike. Consequently, it has created a more flexible labor market all by itself.

Most probably, the 2012 labor market reform has neither been a “raging success” nor a “total fiasco”. It seems more reasonable to call it a small step in the right direction.

Finally, the rapid increase in government debt will inevitably bring into question the sustainability of government debt.

The stock public debt

The outstanding stock of public debt has increased extravagantly, from 35.5 percent of GDP at the end of the first quarter of 2008, to 93.7 percent of GDP at the end of 2013, a phenomenal increase of 58.2 percentage points in just under six years. In 2013, the cost of financing this large stock of debt rose to just under 40.6 euros, or approximately 4 percent of Spanish GDP. If we assume that the growth rate of Spanish nominal GDP in 2014 will be 2 percent, whereas the average cost of financing the debt will be 3.3 percent -two rather conservative assumptions- keeping this debt level constant will require a primary surplus of 0.4 percent, or a further adjustment of 4.4 percentage points of GDP from the 2013 primary deficit of roughly 4 percent of GDP. Again, this is a tall order for Spain, but one that must be filled out somehow, before sufficient and sustained growth returns.

Summing Up

The second contraction of Spanish GDP is over. But the deepest and longest recession in post-civil war Spain is not. As the Eurozone deepens its economic union, Spanish policymakers face two daunting tasks: reforming its labor market until it matches Northern European standards, and reforming its public administrations until its debt to GDP ratio converges back to the Euro Area average. In February 2014, no Spanish politician seemed ready to bell this cat.

Footnotes:

[1] The Eurozone includes the 13 first countries that joined.

[2] We have excluded the Eurozone from our computation of the country averages.

[3] The interested reader can find a good, more technical analysis of the consequences of the reform in: "La Reforma Laboral de 2012: Un Primer Análisis de Algunos de Sus Efectos Sobre el Mercado de Trabajo", available at:
<http://www.bde.es/f/webbde/SES/Secciones/Publicaciones/InformesBoletinesRevistas/BoletinEconomico/13/Sep/Fich/be1309-art5.pdf>

[4] See Schneider, F. (2012) "The Shadow Economy and Work in the Shadow: What Do We (Not) Know?", IZA Working Paper No. 6423.

Το Παρατηρητήριο για την Κρίση

Στο πλαίσιο της οικονομικής κρίσης στην Ελλάδα, της σημαντικότερης στην μεταπολεμική της ιστορία, αλλά και της ευρωπαϊκής κρίσης χρέους, η ανάγκη δημιουργίας μιας πρωτοβουλίας για την σοβαρή και τεκμηριωμένη καταγραφή, μελέτη και ανάλυση τόσο της ελληνικής, όσο και της ευρύτερης ευρωπαϊκής κρίσης καθίσταται επιτακτική.

Την ανάγκη αυτή φιλοδοξεί να ικανοποιήσει το Παρατηρητήριο για την Κρίση. Το Παρατηρητήριο για την Κρίση είναι μια πρωτοβουλία του Ελληνικού Ιδρύματος για την Ευρωπαϊκή και Εξωτερική Πολιτική (ΕΛΙΑΜΕΠ) και λειτουργεί με την υποστήριξη του Ιδρύματος Σταύρος Νιάρχος.

Βασικός στόχος του Παρατηρητηρίου είναι να καταστεί κεντρικός κόμβος ενημέρωσης, έρευνας και διαλόγου για την ελληνική και την ευρωπαϊκή κρίση. Γνώμονας του είναι η σοβαρή και νηφάλια παρουσίαση έρευνας, παρεμβάσεων και πληροφοριών στην βάση τεκμηριωμένων επιχειρημάτων και στοιχείων, φιλοδοξώντας να συμβάλλει στην σταδιακή αναβάθμιση του επιπέδου του δημόσιου διαλόγου γύρω από την κρίση. Για την επίτευξη του στόχου αυτού, το Παρατηρητήριο για την Κρίση οργανώνει την δράση στην βάση τριών βασικών πυλώνων:

- Την παροχή εκπαιδευτικού υλικού με στόχο την αναβάθμιση της ικανότητας του μέσου πολίτη, ο οποίος δεν διαθέτει ειδικές οικονομικές γνώσεις, να κατανοήσει βασικές πτυχές της κρίσης.
- Την παροχή σοβαρής, τεκμηριωμένης και κατά το δυνατό, ευρείας, όσον αφορά την θεματολογία αλλά και τις διαφορετικές πολιτικές προσεγγίσεις, πληροφόρησης για την κρίση.
- Την παρέμβαση στον δημόσιο διάλογο, τόσο μέσω της δημιουργίας ενός βήματος για την ελεύθερη διατύπωση διαφορετικών γνωμών και προτάσεων πολικής, όσο και με την παραγωγή και διάθεση στην δημόσια σφαίρα νέας, πρωτογενούς έρευνας γύρω από την κρίση.

Η ομάδα του Παρατηρητηρίου για την Κρίση είναι η εξής:

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