



SPANISH REFORM MONITOR

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FOREWORD



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In the third release of the Spanish Economy Reform Monitor, we are getting a clearer picture of the past developments in economic policy reform, coupled with the current economic juncture, as well as the main challenges ahead for Spain.

Looking back, the Spanish Government has recently been ranked as one of the top reformers in the Euro Area and the EU as a whole, according to independent assessments of the European Commission and the OECD. This is the main message that emerges from our first Spanish Reform Policy Brief, which surveys and analyzes the most recent cross-country reports by these two institutions. A second insight one gets from our Policy Brief is that Spain's delivery, in relative terms to other countries, has accelerated between 2011 and 2013. Of course, this is the general trend and our Policy Brief offers details on the progress in the 18 policy sub-areas we work on at the SpanishReforms project, including how the reform priorities prescribed to Spain by these institutions have changed over time.

In terms of the current juncture, our panel of experts has produced an average assessment of the current performance of the Spanish economy and the Spanish Government's economic policy with no significant differences from the previous Monitor. One possible interpretation for this is that the expert Spanish opinion has somehow reached a consensus. In aggregate terms across all policy dimensions, both the performance of the Spanish economy and the orientation of the Government's policy are close, but below the pass grade (4.5 out of 10) while the actual progress of the Government in delivering the adequate results is even worse (3.8). This evaluation contrasts with the more positive one of international institutions, which states that Spain performs well in the implementation of reforms relatively to other countries in the EU. The implication is that the reform agenda in Europe seems to have stalled given the limited extent of Spanish reforms. When one looks at the experts' assessment of the Government's delivery by policy subareas, the biggest red lights (i.e. policy dimensions with an average grade lower or equal to 3) are basically the same ones we identified in the previous Monitor: R&D, red tape and the business environment, professional services, active labor market policies, reform of the public administration, and welfare reforms other than those in the health and social security systems. Some of our contributors also point to the pre-electoral climate in Spain as a factor that may freeze economic reforms.

Looking ahead, and adopting a constructive spirit, there a number of policy niches in which our experts consider that the general policies are reasonably set out but the actual delivery is short. The issues with the largest "goal-delivery" gap are the internationalization of the economy, labor market regulations and fiscal consolidation and reform. In these three areas, it could very well be that the additional Government effort in terms of moving from good plans to results becomes particularly productive.

REFORM MONITOR

SPANISH REFORMS

The Reform Monitor is part of the SpanishReforms project, an academic, non-governmental website that aims at being a useful reference for those interested in independent, rigorous and up-to-date information about the Spanish economy and its economic policy reforms.

SpanishReforms intends to foster transparency in policy formulation, to serve as a tool for the evaluation of the reforms enacted in Spain and, ultimately, to help to transform the Spanish economy into a more competitive and growth-friendly one.

SpanishReforms is an initiative of the Public-Private Sector Research Center (PPSRC) at IESE Business School and it has as partners Fincas, which provides financial support; everis, the technological partner, and ESCI-UPF which provides editorial assistance.

Xavier Vives is the academic director of the PPSRC and Ramon Xifré coordinates the SpanishReforms project.

THE REFORM MONITOR

The Reform Monitor quantitatively evaluates three dimensions of the Spanish economy and its much-needed policy reforms: the performance of the Spanish economy; the adequacy of the policy goals set by the Spanish Government; and the actual progress achieved by the reform agenda that has been finally adopted.

These three dimensions are covered for six broad economic policy areas: growth and competitiveness, competition and regulation, the labour market, the financial system, fiscal policy and the public administration, and the welfare state. These six areas, regarding policy goals and progress, are in turn further developed in 18 policy subareas.

To produce the Monitor, six PPSRC-IESE experts have been joined by five of some of the most prominent Spanish economists that collaborate with the project. All experts set scores for all dimensions and areas independently and the only quantitative information we report is the expert average score.

PPSRC – IESE experts:

Alfredo Pastor, Xavier Vives, Antonio Argandoña, Nuria Mas, Lluís Torrens, Ramon Xifré.

External experts:

Antonio Cabrales, Juan José Dolado, Santiago Carbó, Javier Andrés, Sergi Jiménez.

In addition to these numerical evaluations, experts provide a brief comment on the Government's reform agenda in the policy area of their expertise.

As a part of our commitment to independence and plurality, we plan to gradually perform a partial replacement of experts.

Both the Reform Monitor and the experts' comments are released twice yearly.

The Spanish Economy Reform Monitor, 2014-Q3

Assessing current economic performance and monitoring policy reform in Spain

Questions

(1) What is your assessment of the performance of the Spanish economy in this area?

(2) Are the economic policy targets set by the Spanish Government in this area adequate and in consonance with international best-practices? N. B. Absence of commitment by the Government is to be negatively assessed.

(3) Is the economic reform agenda currently implemented by the Government in this area progressing as expected and likely to deliver adequate results?

Reported scores correspond to the average of the expert panel

All scores are in the scale 0 (bad) - 10 (good)

	Spanish economy performance	Spanish Government economic policy	
	(1)	GOALS (2)	PROGRESS (3)
1. GROWTH AND COMPETITIVENESS	4,1 ▼	4,2 =	3,3 =
1.1 R+D and the knowledge society		3,0 ▼	2,1 =
1.2 Internationalization		5,2 =	4,4 =
1.3 Entrepreneurship		4,9 ▼	3,4 =
1.4 Education		3,9 =	3,1 ▲
2. COMPETITION AND REGULATION	4,1 ▲	4,4 ▲	3,1 =
2.1 Competition enforcement		4,3 ▲	3,1 =
2.2 Regulation of product and service markets		4,2 ▲	3,5 ▲
2.3 Red tape and business environment regulation		4,6 =	3,0 =
2.4 Professional services		4,5 =	2,9 ▼
3. LABOR MARKET	3,7 =	4,1 =	3,3 ▼
3.1 Labor market regulations		5,0 ▼	4,1 ▼
3.2 Active labor market policies		3,2 =	2,5 ▲
4. FINANCIAL SYSTEM	5,8 =	6,0 ▲	5,3 =
4.1 Recapitalization and restructuring		6,8 ▲	6,2 ▲
4.2 Other financial measures*		5,1 =	4,5 =
5. FISCAL POLICY AND PUBLIC ADMINISTRATION	4,0 =	4,6 =	3,7 =
5.1 Economic governance**		4,7 ▲	3,7 ▲
5.2 Fiscal consolidation and fiscal reform		5,4 ▼	4,6 =
5.3 Reform of the Public Administration		3,6 ▼	2,8 =
6. WELFARE STATE	4,6 =	4,5 =	3,9 =
6.1 Social Security and pensions		6,1 =	5,5 =
6.2 Health system		4,2 =	3,6 =
6.3 Other welfare state reforms ***		3,3 =	2,6 ▼

Average scores

4,4 =

4,6 =

3,8 =

6

33%

2

11%

Policy areas with average score equal or above 5

Legend

		7 - 10
		5 - 6,9
		3 - 4,9
		0 - 2,9

Variation from previous Monitor

	> 0,2
	[-0,2; 0,2]
	< -0,2

* It includes reforms related to non-bank intermediation, government arrears and SME's access to finance.

** It includes measures to enhance transparency, independence or enforcement of public institutions.

*** It includes reforms related to poverty relief, child and family support and assistance for people with disability.

EXPERTS' COMMENTS

External Experts

1. GROWTH AND COMPETITIVENESS



ANTONIO CABRALES

Professor, Department of Economics, University College London

Professor, Department of Economics, Universidad Carlos III de Madrid (currently on leave)

There is still no change in the public R&D dramatic scenario we depicted in the previous bulletins, and the programme for general R&D projects for this year, which should have been published at the end of 2013, was finally published in July. It will be a rushed evaluation and with little guarantee that the money will be disbursed in time for the research to be done appropriately. The management of basic R&D of this government is arguably the worst in my 20 years as a researcher, and probably the worst ever.

There is finally news on university reform: a Royal Decree modifying the one from 1312/2007 has finally been proposed. It would bring about a timid change in the absurd existing rules for national accreditation and so is just a minor improvement on the current framework. Administrative experience will finally not be necessary for a good researcher to be accredited, which is certainly an improvement. A lack of teaching experience may be waived for first-rate researchers, which is more debatable if they are allowed to teach. But administrative or professional experience can still allow a poor researcher or teacher become a full professor. This is a really bad idea, and it is to be hoped that it will not survive the parliamentary debate of the decree.

2. REGULATION AND COMPETITION



RAMON XIFRÉ

Associate Professor of Economics, ESCI – Universitat Pompeu Fabra

There have been three major issues in this policy area during the past months. A new Law on Telecommunications has been adopted; the Spanish Government attempted -not yet managed- to ring-fence its legal competence for setting the electricity price system, and the developments in the process of the privatization of the company that manages the Spanish airport system (AENA).

The new law on telecommunications clarifies the legal regulatory attributions between the Government and the super-regulator agency (CNMC) placing many competences in the Ministry of Industry that in other countries pertain to the regulators, like the management of the radio-electric spectrum, users' rights and general management of the network. It is true that the law attributes to the CNMC any new or unforeseen regulatory competences that may emerge. However, the current perimeter of functions of the Spanish telecom independent regulator is one of the smallest in the EU. The privatization of AENA was proceeding smoothly, as there was a pre-agreement between the Government and a selected group of core and stable potential investors. However,

the wider regulatory model of the Spanish air transport system needs a deeper transformation (beyond privatizing) towards a more decentralized, competition-driven mode. In addition, there have recently been some problems in the formal procedure of the privatization that may freeze the process until 2015. Finally, the Spanish Government has manoeuvred -in a not fully transparent way- to keep for itself the legal competence to design the electricity tariff and price system, taking it away from the CNMC. Should this last move of the Government become law, this would apparently contradict the EU Directive on the issue.

The overall assessment of the Government's line of action in this area, therefore, cannot be positive.

3. LABOUR MARKET



JUAN J. DOLADO

Professor, Department of Economics, European University Institute

Professor, Department of Economics, Universidad Carlos III de Madrid (currently on leave)

In my previous comment I wrote that "the outlook for the Spanish labor market remains a very major concern, although there are signs of a mild recovery starting in 2014-Q2." Indeed the excellent results of the EPA-2014Q2 confirm that the GDP threshold associated to net job creation has fallen from about 2% to about 1.2%, as a result of the drastic reduction in real labour costs, especially for young individuals entering the labour market. However, most of these jobs are fairly precarious and seasonal in nature, so that they are likely to be destroyed sooner than later. As a result, it is unlikely that we will end this year with an unemployment rate below 23%, despite the steady reduction in the labour force.

The 2012 labour market reform has been successful in decentralizing wage setting from sectoral to firm-bargaining levels but it is failing in improving long-term competitiveness via occupational training and specialization in higher value-added industries. This could be dangerous if the Eurozone remains stagnant.

Very little is being done regarding youth unemployment (53.1%) where it is crucial to reform the public employment services and to allow private agencies intermediating in job seeking and training activities. In this respect, although the recent agreement on the Youth Guarantee (YG) implies that Spain will get 1.85 billion euros in total over the next seven years out of the 6 billion budgeted for this initiative, the figure is not so large. First, because it only represents a quarter of the cumulated cuts in Active Labour Market Policies since 2011. And secondly, because the targeted population of the YG in Spain are 750 thousand NEETs (not employed, nor in education and training) aged 16-25, among which 190 thousand do not search employment actively. As a result, the available annual funds for Spain imply slightly less than one euro per day for each of these individuals.

4. FINANCIAL SYSTEM



SANTIAGO CARBÓ

Professor of Economics and Finance, Bangor Business School

The restructuring process that Spanish banks have gone through over the last few years has imposed many sacrifices, but it may also bring about many competitive advantages in the near future. However, some of the most important ones are still to come, such as those related to the increase in lending to the real economy. Some duties still remain regarding the restructuring process of the Spanish banking sector, including the privatization of State-owned banks where the Spanish resolution fund (FROB) still has a majority stake. Progress has been made during 2014Q2 and 2014Q3 but this re-privatization process will still take time to be completed. Additionally, there are also substantial and long-term potential efforts to be made for the asset management company Sareb, which has experienced substantial changes in its governance structure and its business strategy over the last quarters to reshape its activity.

Spanish banks are facing a tight regulatory scrutiny challenge which has resulted in a combination of asset deleveraging and equity increase. Overall, Spanish banks seem to be well-prepared ahead of the stress tests and asset quality reviews that are being conducted by the European Banking Authority and the ECB. In any event, market pressure has not only been placed on solvency but also on margins. All in all, it seems that the Spanish banking sector has already passed the turning point due to previous reforms and it seems well-prepared to face the challenges ahead. However, downside risks affecting the European economy should also be considered as a threat in the near future.

5. FISCAL POLICY AND PUBLIC ADMINISTRATION



JAVIER ANDRES

Professor of Economics, Universidad de Valencia

For the first time since 2011, the government proposal for next year's budget envisages a neutral or slightly countercyclical fiscal stance. Since 2015 is an electoral year, it is quite likely that important reforms concerning the structure of public spending (public administration reforms) as well as the efforts to consolidate public debt will be postponed. In recent years, Spain has faced strong headwinds in trying to meet its fiscal goals through spending cuts and tax increases. Although the public debt as a proportion of GDP has reached historical levels and is expected to increase even further in the coming months, the Spanish government might still manage to reduce the deficit to 4.2 per cent of GDP in 2015, despite the reduction of income and corporate tax rates if the central scenario of moderate growth materializes. This scenario (1 to 2% average GDP growth for 2014-2015) may be jeopardized by the slowdown in growth rates in Europe. On the other hand, the depreciation of the euro and further easing of monetary and fiscal policies in the Eurozone could help us to achieve our fiscal targets.

6. WELFARE STATE



SERGI JIMÉNEZ

Associate Professor, Department of Economics, Universitat Pompeu Fabra
Director of LaCaixa-FEDEA Chair on Health Economics at FEDEA

The assessment of the second and third quarters of 2012 is still quite pessimistic, despite some signs of improvement. Although in the second and third quarter of 2014 the Social Security has won contributors timidly (the annual rate of growth in August 2014 was 1.6 percent), the gains are still modest and do not compensate for the sustained growth of pension expenditures (about 3 percent despite the pension freeze). More importantly, the current short and long term perspectives of Social Security balances are not good. In the short term, the rate of growth of contributors could be seriously affected by the European slowdown. In the long term, demographic forecasts are increasingly pessimistic, implying a loss of population of around four million by the year 2052. The loss is especially intense where it hurts, in the 25-50 age group. In this context, the dependency ratio would increase from 26.1% to 73% in 2052.

In a context of a mild fiscal expansion (we are entering an election year), given the severe budget constraints of the Spanish regions, we do not expect short-term improvements in the quality (and quantity) of health services. With regard to long term care, despite a 5 percent increase in the budget for social services, Central Government funding remains stagnant (0.11 percent of GDP). The prospects for other social services and programs are not much better, but at least we do not expect further deterioration of social services. In short, the forecast on the future of the welfare state is reserved.

IESE Economists



ALFREDO PASTOR

Professor of Economics, Department of Economics, IESE Business School
Banco Sabadell Chair of Emerging Markets

The second quarter of 2014 has seen a modest recovery in Spain: higher competitiveness, thanks to a substantial reduction in unit labour costs, has generated a modest current account surplus for the first time in years, and lower interest rates on public debt have lightened the burden of debt on the budget, although in absolute value it has continued to grow: the debt-to-GDP ratio has reached the 100% mark.

There are reasons to believe that this recovery may not last: domestic consumption –car purchases excluded– remains flat, possibly reflecting the debt overhang on households; exports may suffer from symptoms of weakness in the rest of the Eurozone, while a surge in imports threatens to yield a negative current account balance.

The Spanish Government has earned good scores from international institutions (OECD, EU Commission) for its willingness to accept their policy recommendations. In Spain's situation, this was a good strategy to follow, and it has had the expected results: bank recapitalization has resulted in a healthier banking sector, while fiscal consolidation has resulted in lower growth than would have been desirable, or indeed feasible.

In other aspects having to do with deregulation, increased competition in the product markets or licensing of professional services progress has been in-existent. The contents of the new education law have proved contentious in some regions (Catalonia and Euskadi), and so the next academic year may give some indication of its effectiveness.



ANTONIO ARGANDOÑA

Emeritus Professor of Economics and Business Ethics, IESE Business School.
"La Caixa" Chair of Corporate Social Responsibility and Corporate Governance

The labor market reforms implemented during 2013 have had a positive effect on the creation of employment in 2014, along with the recovery of exports in the second half of 2013 and of the domestic demand in the first months of 2014. But the momentum due to the reforms has eroded: the growth of aggregate demand remains weak, and the triumphalism on the growth of the Spanish economy compared with that of other European countries does not seem justified: it is not sustainable, and it has not been accompanied by new incentives for job creation.

Since the previous Report, no new important measures have been taken in the front of labor reforms, and neither the government nor the social partners seem determined to take new steps in this area, at least until the 2015 general elections.

Therefore, many fronts remain open: the promotion of jobs for youth and long-term unemployed workers, the reform of active policies for workers with low qualifications, the simplification of the types of contracts, the reduction of social security taxes (and its possible compensation with an increase in value added tax), the reform of the public services of employment and a new vocational training model, among other reforms. The political parties, trade unions and employers are reluctant to undertake major changes in the labor framework, but those changes are necessary, if we do not want to have a very high unemployment rate for many years. A prolonged rigid and inefficient labor market could become a brake on the potential growth of the Spanish economy in the not too distant future.



NÚRIA MAS

Associate Professor of Economics, IESE Business School

Unemployment rates remain huge in Spain. Even though in the last months there has been some increase in the employed population in Spain, however, progress is still worryingly slow. On the healthcare front, progress remains subdued. Until now, most of the attempts have focused on controlling costs and creating a Centralized purchasing Entity for some drugs and medical products. However very little progress has been done regarding key issues such as improving efficiency, encouraging value-based care or aligning incentives.

Regarding pensions, the main change was implemented with the Reform of 2013. This reform includes two new elements: the Annual Revaluation index (IRA), which aims at linking income and spending, and a sustainability factor which links pensions and life expectancy. However, this is not going to be implemented until 2019.

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The PPSRC at IESE was created in October of 2001 with the mission to foster cooperation between the private sector and public administrations as well as the exchange of ideas and initiatives, through dialogue, research and education. The aim is to open a way of cooperation and exchange of ideas and initiatives. In 2010, the PPSRC developed a Decalogue of reforms to be undertaken by the Spanish Government and this website continues on with the Decalogue.

Partners





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