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The Spanish Export Led Recovery

Abstract

I researched the export-led recovery currently taking place in Spain. My thesis revolved around Mariano Rajoy and the Popular Party coming into power in 2011 and instituting reforms in three distinct categories; financial market reforms, fiscal measures, and labor market reforms. These reforms have had a significant impact in restoring credibility in Spain's capital markets and decreasing unit labor costs. In turn, Spain has shown impressive export growth in the past two years, especially compared to its neighbors Italy and France.

Keywords

Exports, Reforms, Spain

In this thesis, I will give a background of the Spanish crisis, followed by a detailed account of the reforms the Spanish government instituted in response. I will then describe the effects of these reforms, especially as they relate to the exports of the country. Finally, I will predict the sustainability of these reforms and lay out risk factors that could affect the export led recovery in Spain.

I Introduction

2008 marked the 30th year of Spain's constitutional monarchy, leaving behind a dark past. From 1939 to 1975 a dictator, Francisco Franco, ruled Spain. During these years, Franco propagated the message that Spain was the monarchy that defended Catholicism above all else. Any anti-government, anti-Catholic, or anti-Spanish expression was suppressed, and *las dos Españas* evolved; one that held strong traditional, religious ties and one that hoped to break free from the oppression of the dictatorship.¹

In 1978, three years after the death of Franco, the Spanish people came together to create a constitutional monarchy. They named King Juan Carlos head of state and proclaimed themselves a secular nation with seventeen autonomous regions, ranging from Galicia in the northwest to Andalusia in the south. The government created by the 1978 constitution remains in place today, and presides over a country of 46 million people with a GDP of \$1.3 trillion, making it the fourth largest economy in Europe.

Today, Spanish culture is first and foremost distinguished by its seventeen autonomous regions. During the evolution of civilization in the Iberian Peninsula, cities sprang up along the coastlines with little interaction. The Pyrenees mountain range isolated Spain from France to the north, other mountain ranges made for a natural border in the interior of Spain, and the sea served as a border from the exterior. Distinct cultures arose based on the various climates and inhabitants of the different cities, including a *Catalán* culture surrounding Barcelona in the northeast, a *Gallego* culture in the northwest, an *Andaluciano* culture to the south, and a *Vasco* culture in the north. The overarching cultural differences from hundreds of years ago persist today, as do tensions between the cities. The regional differences that have developed over the years create fragmented political and economic systems that have caused local budgets to balloon and the grasp of the central government weaker.²

Another key cultural aspect of Spain today is the rise of immigration. The population of Spain grew from 40 million to 45 million from 2000 to 2008 while the birth rate of Spanish women was only 1.6, below the rate of 2.1 that is necessary to maintain a population. Further, from 1999 to 2007, the Spanish economy created a third of all new jobs in the European Union.

The majority of the jobs were low-paying, and people began flooding in from primarily North Africa. Tensions arose as the North Africans were willing to work for

¹ Tremlett, Giles. *Ghosts of Spain: travels through Spain and its silent past*. New York: Walker & Co. :, 2007. Print.

² Operé, Fernando, and Carrie B. Douglass. *España y los españoles de hoy: historia, sociedad y cultura*. Upper Saddle River, N.J.: Pearson Education/Prentice Hall, 2007. Print.

less money than Spaniards, and set the stage for racial conflict when the economy took a turn for the worse in 2008. Immigration has changed the landscape of Spain, creating an economy with more low paying jobs and a larger base of low-income residents expecting social services.³

According to Geert Hofstede, the most distinctive part of Spanish culture is its uncertainty avoidance. For example, 75% of young people in Spain said they would like to work in civil service, also defined as a job for life, compared to only 17% of young people in the United States.⁴ This uncertainty avoidance has led to a society that looks harshly upon failure, and that lacks an entrepreneurial spirit. While many say that entrepreneurship is currently on the rise in Spain,⁵ data would suggest otherwise. The number of business starts has dropped steadily, from 410,975 in 2008 to 332,229 in 2012. Furthermore, the median capital investment to an entrepreneur was €18,000 in 2012, compared with €30,000 in 2011.⁶ Despite the hope that entrepreneurs will appear out of mere necessity, Hofstede's assertion that Spanish culture is defined by uncertainty avoidance seems to be holding true, and it seems as if Spain will not be able to exit from recession through new business starts within the country.

In 2007, Spain's growth prospects looked promising as investment was pouring into the real estate sector with house prices rising 250% in the previous 5 years.⁷ Moreover, GDP was on an upward trend, growing by at least 3% in each of the past 5 years. Yet, a combination of a housing bubble, various structural problems and the global financial crisis pushed Spain into its deepest recession since it became a democracy.

When Spain joined the Euro Zone in 2002, it was relatively less developed than the rest of the currency union. The lack of development meant higher yield projects were available in Spain, and with easier mobility of capital and people, investments started flowing into Spain, as its capital account surplus rose from \$83 billion in 2005 to \$155 billion in 2008. Northern Europe, and specifically Germany, became an export machine, and invested some of its current account surplus in Spain. Consequently, Spain continuously ran a current account deficit, reaching 10% of GDP by 2007.⁸

³ Ibid

⁴ Hofstede, Geert. "Spain." *The Hofstede Centre*. N.p., n.d. Web. . <<http://geert-hofstede.com/spain.html>>.

⁵ Rooney, Ben. "Spain's Financial Crisis a Boost to its Startup Economy." *WSJ*. N.p., 17 Oct. 2013. Web. . <<http://blogs.wsj.com/tech-europe/2013/10/17/spains-financial-crisis-a-boost-to-its-startup-economy/?KEYWORDS=spain>>.

⁶ Mars, Amanda. "Mitos del 'boom' emprendedor." *El Pais*, 6 Nov. 2013. Web. . <http://sociedad.elpais.com/sociedad/2013/11/06/actualidad/1383766164_765200.html>

⁷ "The adjustment of the Spanish Real Estate Sector." *Ministerio de Fomento*, 1 Jan. 2012. Web. . <http://www.fomento.gob.es/NR/rdonlyres/D02CD420-9CF2-4E91-AB0B-B37F66B94565/109402/adjspa_real_estate_JAN2012.pdf>.

⁸ "Current Account Balance." *The World Bank*. N.p., n.d. Web. . <<http://data.worldbank.org/indicator/BN.CAB.XOKA.CD?page=1>>.

Much of the investment that came into Spain went into real estate. Housing investment in Spain sat at 9.5% of GDP in 2007,⁹ twice that of the European average. Further, in the year preceding the crisis, there were more housing starts in Spain (population 45 million) than in Germany, France, and Italy combined (population 204 million).¹⁰

Moreover, Spanish culture has an effect on the housing sector in the country. The general avoidance of uncertainty, as well as the availability of 40- and 50-year mortgages, led to a homeownership rate of over 80% in 2011, compared to a rate of about 65% in the UK and under 45% in Germany. In addition, the housing sector in Spain can be characterized by the amount of secondary and vacation housing. In 2004, Spain had 160 secondary houses per 1,000 habitants, compared with the EU average of 75.¹¹

The myth that real estate in Spain would never decrease in value was dispelled. The bubble hit a breaking point in the beginning of 2008. Since that time, housing prices have fallen by 37%.¹² Meantime, production of houses was halted. The construction sector, which made up 17% of the economy in 2007,¹³ fell precipitously and income and wealth around the country dissipated. In the span of one year, a country dependent on domestic demand lost two million jobs and fell into crisis.

Moreover, non-financial corporations and households had increased debt in a time of low-cost financing. With the introduction of the Euro, Spain's interest rate converged to that of Germany's, from a 100 basis point spread in 1997 to virtually even in 2005,¹⁴ but the risks were not properly priced. Further, non-financial companies held nearly 220% of private debt to GDP, compared to 150% in France and 122% in Italy.¹⁵ Suddenly, with the loss of wealth and incomes, the private sector of the country defaulted on many of its loans. The housing bubble popped, throwing Spain into a crisis with over 25% unemployment, a depressed tax base, and increased government entitlement spending.

⁹ "The Residential Investment Adjustment in Spain: The Current Situation." . Banco de España, 20 Dec. 2010. Web. . <<http://www.bde.es/f/webbde/SES/Secciones/Publicaciones/InformesBoletinesRevistas/BoletinEconomico/11/Ene/Files/art3e.pdf>>.

¹⁰ Chislett, William. "What does the economic future hold for Spain?." . N.p., 25 Mar. 2014. Web. . <<http://www.williamchislett.com/2014/03/what-does-the-economic-future-hold-for-spain/>>.

¹¹ "The Residential Investment Adjustment in Spain: The Current Situation." . Banco de España, 20 Dec. 2010. Web. . <<http://www.bde.es/f/webbde/SES/Secciones/Publicaciones/InformesBoletinesRevistas/BoletinEconomico/11/Ene/Files/art3e.pdf>>.

¹² Karaian, Jason. "Spanish real estate has lost more than a third of its value, but it's still overvalued." *Quartz*. N.p., 13 Sept. 2013. Web. . <<http://qz.com/124088/spanish-real-estate-has-lost-more-than-a-third-of-its-value-but-its-still-overvalued/>>.

¹³ Etxezarreta, Miren. "Boom and (deep) crisis in the Spanish economy: the role of the EU in its evolution.." . N.p., 1 Sept. 2011. Web. . <http://www2.euromemorandum.eu/uploads/ws1_etxezarreta_et_al_boom_and_deep_crisis_in_the_spanish_economy_the_role_of_the_eu_in_its_evolution.pdf>.

¹⁴ "Spain Government Bond 10Y." *Trading Economics*. N.p., n.d. Web. . <<http://www.tradingeconomics.com/spain/government-bond-yield>>.

¹⁵ "Private debt in % of GDP." *Eurostat*. N.p., n.d. Web. . <<http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&plugin=1&language=en&pcode=tipspd10>>.

Much of Spain's inability to cope with the housing crisis can be linked to the structure of the Spanish economy. The labor market was rife with archaic laws and inflexibility. While the economy lost 2 million jobs between 2008 and 2009, compensation level per employee actually increased 6%.¹⁶ The collective bargaining agreements could not be negotiated and the labor unions demanded that their wages not be lowered. The inability to change costs and prices only led companies to lay off more employees, and worsened the economic situation.

Further, much of the banking system of Spain was largely unregulated and inefficient. Regional politicians ran and regulated 45 '*cajas*', or savings banks. The *cajas* held half of all banking assets in Spain and were not required to divulge a history of repayment, loan to value ratios, or collateral on loans to the central bank of Spain. In 2009, the *cajas*, effectively a "shadow banking" system, held 56% of all mortgages in Spain. Additionally, the payments on the mortgage loans made up a significant portion of the *cajas* revenue, approaching a ratio of 20% of all assets.¹⁷ The combination of the availability of cheap financing and the fact that the *cajas* did not have to disclose loan information to the government led to excessively risky, and unregulated, lending. As the bubble burst, almost 5% of all mortgages held by the *cajas* were underwater,¹⁸ and financial institutions across the country were unable to extend credit in Spain.

Finally, the structure of the Euro Zone did not allow Spain to address the downturn effectively. When Spain agreed to join the monetary union, it also agreed to give up its monetary policy and its influence over interest rates. Domestic demand plummeted in the aftermath of the housing bubble bursting, and Spain would have benefited from devaluing its currency to make exports more attractive. Previously, in times of low domestic demand, Spain had devalued the *peseta*, its previous currency, and increased exports to spur growth. Yet now the Euro Zone, spearheaded by Germany, was unwilling to depreciate the Euro.

Further, because Spain could not devalue its currency, it was also unable to lower its interest rates to free up credit and encourage companies to invest. With no monetary policy power, nor the ability to lower wages, Spain had very few tools to fight the declining state of the economy.

Given all of the structural problems and the housing bubble, Spain fell into a deep recession. The global financial crisis merely exacerbated its problem. On top of domestic demand declining and showing no signs of increasing, global demand for Spanish products decreased as well. Over 60% of all Spanish goods went to countries in the European Union, the area hit hardest by the financial crisis.¹⁹ With the European Union showing little signs of recovery, the Eurozone's intransigence in its policies

¹⁶ "Labour Compensation per Employee." *OECD*. N.p., n.d. Web. .

<<http://stats.oecd.org/Index.aspx?queryname=430&querytype=view>>.

¹⁷ Minder, Raphael. "Mix of Politics and Banking in Spain's Woes." . N.p., 3 June 2010. Web. .

<http://www.nytimes.com/2010/06/04/business/global/04caja.html?_r=2&sq=spain%20cajas&st=nyt&adxnnl=1&scp=1&pagewanted=1&adxnnlx=1397575120-qk4bv5l9tZONhqjvyD9MCA>.

¹⁸ "Savings and Groans." . *The Economist*, 19 Nov. 2009. Web. . <<http://www.economist.com/node/14924481>>.

¹⁹ See Exhibit C

towards the periphery, and the problems that existed inside Spain, internal structural reforms were necessary.

II Reforms

By 2008, the Spanish government was borrowing at a rate of nearly 5%,²⁰ and businesses were hard pressed to find financing at any rate. The future of Spain was uncertain as investors and business owners questioned whether Spain would stay in the Eurozone. Hiring and credit markets froze; unemployment rose to 20% in 2010 from 8% in 2008²¹ and loans over €1 million to companies dropped 25% from 2009 to 2010²², as companies awaited a response from the Spanish government. Yet, then Prime Minister José Luis Rodríguez Zapatero was slow to institute any significant reforms. The socialist leader had political pressure from the left to uphold government services and labor-friendly labor laws.

Finally, in 2011, Mariano Rajoy was elected as a more conservative candidate from the People's Party, as voters showed their frustration with Zapatero's response to the crisis. With an absolute majority in the legislature with 186 of 350 seats, Rajoy immediately began implementing reforms to address the issues.²³

The reforms that the Rajoy government enacted in response to the crisis, highlighted in Table 1 at the bottom of the section, can be placed into three main categories: financial market reforms, fiscal measures and labor market reforms. Each reform was put into place to stabilize the macroeconomy of Spain and to allow for the return to capital markets for both the government and businesses. The Spanish economy needed a renewed sense of credibility within global markets, and the reform effort was aimed at reinstating this credibility to put Spain on the road to recovery.

Financial Market Reforms

To restore confidence in the periphery: countries like Spain, Portugal, Ireland and Greece outside the core of Europe, on August 2, 2012 the European Central Bank's president Mario Draghi announced that the ECB was prepared to undertake Outright Monetary Transactions (OMT) to aid ailing countries, and that Spain would be granted up to €100 billion to salvage its banking system.²⁴ The ECB recognized that the system that had allowed for the origination of millions of mortgages in Spain, many of which were to subprime borrowers with little equity to back up the loans, needed to be changed. In exchange for the ECB's pledge of support, Spain was required to administer certain reforms in its financial system.

²⁰ "Spain Government Bond 10Y." . Trading Economics, n.d. Web. .
<<http://www.tradingeconomics.com/spain/government-bond-yield>>.

²¹ "Spain Unemployment Rate." . Trading Economics, n.d. Web. .
<<http://www.tradingeconomics.com/spain/unemployment-rate>>.

²² Lafraya, Conchi. "Las contradicciones del credito." *La Vanguardia* 7 Apr. 2014: n. pag. Print.

²³ Tremlett, Giles. "Spanish election: convincing victory for People's party." *The Guardian* 20 Nov. 2011: n. pag. Print.

²⁴ "Technical features of Outright Monetary Transactions." *European Central Bank*. N.p., 6 Sept. 2012. Web. .
<http://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html>.

First, on August 31, 2012, with the Spanish Royal Decree-Law 24/2012, the Spanish Government created SAREB (*Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria*) that functioned as a typical 'bad bank.'²⁵ €40 billion worth of assets were transferred from four of Spain's previously nationalized financial institutions: BFA:Bankia, Catalunya Banc, NGC Banco-Banco Gallego and Banco de Valencia. These assets consisted of bad loans from the mortgage crisis and allowed the original institutions to focus on their business while a new entity could focus solely on the restructuring and sale of the bad assets. The government branch, the Fund for Orderly Bank Restructuring, owns 45% of SAREB while private shareholders hold the other 55%. The bank has 15 years to dispose of the assets and aims to make a 15% cumulative profit.²⁶

The next task was to better capitalize Spain's functioning banks. Many banks, with low amounts of capital in the first place, had yet to write off all of the underperforming loans due to the housing crisis. In order to avoid another crisis of the same scale, and instill confidence in the banking system, the European Union ordered banks to raise their capital levels in line with the European Central Bank stress tests of 6% of assets.²⁷ Banks receiving state aid were required to shed their riskiest assets to comply with risk-weighted capital requirements.

Finally, Spain set out to rein in the largely unregulated '*caja*' system that had been in place for hundreds of years. Spain instituted a reform of the framework for regulation, allowing for a Single Supervisory Mechanism over the banking system and enhancing the *Banco de España*'s regulatory and supervisory powers, granting them sanctioning and licensing power. The reforms required that the *cajas* have formal shareholders with a system to distribute profits, and attempted to centralize the regulatory authorities in order to place the same requirements on all banks and reduce the risk of shadow banking that helped lead to the housing bubble of 2008.²⁸

Each of these reforms attempted to restore the banks' access to funding markets, to allow for banks to start lending to businesses once more and, eventually, to propel the economy forward.

Fiscal Measures

In the aftermath of the crisis, the Spanish budget immediately saw a disproportionate decrease in revenues rather than a significant increase in expenditures. The Spanish government increased its expenditures by a cumulative 6% of GDP from 2007 to 2011,

²⁵ Pallares, Ignacio. "Royal Decree Law 24/2012 address restructuring and termination of Spanish credit entities." *Lexology*. N.p., 24 Sept. 2012. Web. . <<http://www.lexology.com/library/detail.aspx?g=a6c8c9c8-e2ca-4299-b54f-af044129903a>>.

²⁶ "Spain: Financial Sector Reform - Fourth Progress Report." . International Monetary Fund, 1 Nov. 2013. Web. . <<https://www.imf.org/external/pubs/ft/scr/2013/cr13331.pdf>>.

²⁷ *Ibid*

²⁸ "Financial Assistance Programme for the recapitalisation of Financial Institutions in Spain." . European Commission, 1 Jan. 2014. Web. . <http://www.bde.es/f/webbde/GAP/Secciones/SalaPrensa/InformacionInteres/ReestructuracionSectorFinanciero/Ar c/Fic/en/comision_informeevaluacion012014en.pdf>.

which was in line with the rest of the Eurozone; in fact, its level of expenditure in 2011 (45% of GDP) was below the Eurozone average of 50% of GDP. Revenues, on the other hand, decreased 5.4% of GDP from 2007 to 2011, more than any other country in the Eurozone. Further, Spanish revenues were only 36% of GDP in 2011, compared to the Eurozone average of 45% of GDP. The problem of revenues was a direct consequence of the housing crisis in Spain; many of the taxes collected in the period before the crisis were temporary taxes linked to the transfer of property. Additionally, as unemployment rose, Spanish income tax revenues decreased.²⁹

To combat the fiscal problems, Spain has gone through two distinct phases: an expansive phase from 2008-2009 and a consolidation phase from 2010 to the present day. Both phases came at the recommendation of the European Union, and have produced significant effects on the fiscal situation of Spain.

During the expansive phase, Spain merely added to its budgetary problems. It instituted tax cuts totaling 1.8% of GDP in 2008 and 2009 and introduced liquidity support to households and companies that reduced revenues by an additional 1.2% of GDP. Further, the governments introduced a fund for local public investment and a fund to aid strategic sectors which added an additional 1.1% of GDP to expenditures. Due to these policies, Spain shifted from a budget surplus of 2% in 2007 to a deficit of 11% in 2009, and public debt increased from 36% to 54% of GDP from 2007 to 2009.³⁰

The consolidation phase came as the European Union realized the need for the periphery of Europe to shore up its accounts in order to raise public debt at affordable levels, and the EU placed austerity measures on Spain. The government instituted revenue measures with an expected positive impact of 3.9% of GDP by raising the value added tax rate from 21% to 18% and significant income-tax increases. Additionally, the government laid out expenditure measures with an expected reduction of 3.5% of GDP, most notably, cutting jobless benefits and public-sector wages by 7% and reducing departmental budgets by 17%.^{31 32}

Another important aspect of Spain's fiscal landscape is the presence of autonomous regions, roughly equivalent to states in the United States. The regions, through health care, education and social services, outlay 35% of total government expenditures in Spain, yet bring in only 19% of total revenues in taxes. The deficits are filled in by transfers from the central government, contributing to 56% of the deficit in 2009.

Currently, reforms are being made by the central government to ensure that the regions practice fiscal responsibility and to more properly allocate capital to regions to

²⁹ "Austerity Measures in Crisis Countries - Results and Impact on Mid-term Development." *Intereconomics* (): 21-26. Print.

³⁰ Ibid

³¹ "EU austerity drive country by country." *BBC*. N.p., 21 May 2012. Web. . <<http://www.bbc.com/news/10162176>>.

³² Roman, David . "Madrid Austerity Plan Boosted to \$80 Billion." *The Wall Street Journal*. N.p., 12 July 2012. Web. . <<http://online.wsj.com/news/articles/SB10001424052702303919504577520213420179248?mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB10001424052702303919504577520213420179248.html&fid=2,7,121,122,201,401,641,1009>>.

reflect the proper use of government resources. Additionally, Rajoy is implementing a system by which the central government can place austerity measures on the regions in exchange for financing, similar to Europe's treatment of Spanish finances. This would force regions to start raising personal-income taxes and decrease spending on public services.³³ Specifically, the government is requiring that the regions aggregately raise revenue and decrease expenditures by €4 billion in both 2014 and 2015.³⁴

Labor Market Reforms

As domestic demand in Spain decreased due to the housing crisis and subsequent employment crisis, Spain needed to become more competitive in the global market place. Most countries would use their central banks to lower interest rates and devalue their currencies, yet this option was not available to Spain because of its participation in the Eurozone. The other option to increase competitiveness globally was to decrease unit labor costs, which would in turn allow Spanish exporters to reduce their prices.

Spain was renowned for its archaic labor laws, as companies found it difficult to fire employees, employees enjoyed early retirement with full pensions, powerful collective bargaining positions, and, most importantly, constant wage increases. While its GDP (-7%) and employment (from 9% to 20% unemployment) levels fell precipitously in the three years beginning in 2008, Spain's unit labor costs actually increased by an average of 1.7% a year.³⁵ Spain began to address these issues with a labor reform in 2010, but it wasn't until February 10, 2012 with the Royal Decree Law 3/2012³⁶, that Rajoy was able to enact a monumental labor reform.

The 2012 labor reform consisted of two main initiatives: reforming the collective bargaining aspect of Spanish labor and adjusting the employment protection legislation. The reforms attempted to hit the heart of the matter; Spain needed to reduce its labor costs and had to wrest power from its employees.

The first step was to give priority to collective bargaining agreements (CBA) at the firm level over those established at the sector or regional levels. This allowed for Spanish firms to become more competitive amongst each other, and made it easier to decrease wages without strikes. The new CBA reforms allowed for firms to opt out of an agreement and implement "internal flexibility", meaning firms could introduce unilateral working condition changes for economic or productivity reasons. For example, Spanish firms were now able to change the wages and working hours of employees in order to increase profits, a practice that was unheard of before 2012. In addition, in the absence

³³ "Austerity Measures in Crisis Countries - Results and Impact on Mid-term Development." *Intereconomics* (); 21-26. Print.

³⁴ "The Spanish Government imposes an €8 billion budget adjustment on the Autonomous Communities in 2014 and 2015." *Catalan News Agency*. N.p., 17 Oct. 2013. Web. . <<http://www.catalannewsagency.com/politics/item/the-spanish-government-imposes-an-8-billion-budget-adjustment-on-the-autonomous-communities-in-2014-and-2015>>.

³⁵ "Unit Labour Costs - Annual Indicators." *OECD*. N.p., n.d. Web. . <https://stats.oecd.org/Index.aspx?DataSetCode=ULC_ANN>.

³⁶ "Royal Decree-Law 3/2012 of urgent measures to reform the employment market." *Herbert Smith*. N.p., n.d. Web. 1 Feb. 2012. <[http://www.herbertsmithfreehills.com/-/media/HS/MA-210212-9%20\(2\).pdf](http://www.herbertsmithfreehills.com/-/media/HS/MA-210212-9%20(2).pdf)>.

of an agreement of internal flexibility, an employer could refer the matter to a relatively speedy arbitration rather than go through a full review by labor courts, allowing changes to a company's workforce to go through more quickly without high costs for litigation.

The employment protection legislation, specifically relating to regulations on hiring and firing, was also made more business friendly. The definition of fair economic dismissal was reshaped to mean that dismissal is always justified if a company faces three quarters of decline in revenues or income. In other words, companies no longer had to prove that dismissals were essential for future profitability. The reforms also reduced monetary compensations for dismissal and eliminated the requirement of administrative authorization for collective redundancies. Traditionally in Spain, in order to lay-off a large amount of workers, companies had to obtain government approval, and government approval was sometimes denied if the company could not agree with the union board about the layoffs. Now that government approval was no longer necessary, companies could perform massive layoffs without consulting union boards.³⁷ Finally, the law instituted "*contrato emprendedores*," which allowed firms under 50 employees to have a one year trial period for full-time employees, attempting to spur hiring by entrepreneurs.³⁸

The new labor reforms modified a labor system that was strongly rooted in the 'uncertainty avoidance' of Spanish culture discussed in the introduction of this thesis, with many protections for workers. With a gloomy outlook on the future of domestic demand due to the high unemployment and debt levels, and the lack of ability to institute monetary policy, Spain saw labor reform as the best way to increase its global competitiveness.

³⁷ Candel, Maria Teresa. "Spain passes major labour law amendments." *Lexology*. N.p., 2 Apr. 2012. Web. . <<http://www.lexology.com/library/detail.aspx?g=90b8634c-7137-4b15-b2b8-bb3d7c4b78a3>>.

³⁸ "The 2012 Labour Market Reform in Spain: A Preliminary Assessment." *OECD*. N.p., 1 Dec. 2013. Web. . <<http://www.oecd.org/els/emp/SpainLabourMarketReform-Report.pdf>>.

Table 1

<i>Reform Type</i>	<i>Date</i>	<i>Reform</i>	<i>Intended Impact</i>
Financial Market	August 2, 2012	Mario Draghi announces Outright Monetary Transactions by the ECB	Lower borrowing costs for the periphery countries of Europe
Financial Market	August 31, 2012	The Spanish Government creates 'SAREB' to function as a bad bank	Allow banks to get rid of bad assets and focus on core business
Financial Market	August 31, 2012	The European Central Bank places a capital requirement of 6%	Clean up banks to avoid another crisis in which capital freezes
Financial Market	August 31, 2012	A Single Supervisory Mechanism is created in Spain to regulate <i>cajas</i>	Decrease the risk of shadow banking and increase regulation
Fiscal	2010	The EU places austerity measures on Spain, slashing spending and raising revenues	Balance the Spanish budget and instill confidence in the Spanish economy
Labor Market	June 18, 2010	Spain, under Zapatero, institutes a weak, ineffective labor reform	Lower unit costs of labor
Labor Market	February 10, 2012	Rajoy enacts reforms on collective bargaining and employment protection	Lower unit costs of labor and costs of hiring and firing workers

III Direct Effects of Reforms

The reforms implemented by the Rajoy administration have been largely linked to an 'export-led recovery' to lead Spain out of its crisis.³⁹ Domestic demand has decreased so significantly, with no real signs of recovery, that growth will initially come from outside Spain. The growth in exports will help companies pay down debt faster, create more tax revenues for the government, and create more jobs inside Spain, each of which will eventually lead to higher domestic demand.

The three areas of reform have attempted to address the issue of increasing Spanish competitiveness, and this section will show that while the reforms have had some success, the full effects of the reforms will not be felt for many years to come. Moreover, there are a few key risk factors associated with the reforms that could derail the recovery.

Financial Market Reform Effects

While the effects of financial and budget reforms do not seem to have a direct correlation with increasing exports, they are important in reestablishing credibility for the Spanish economy to the outside world and decreasing cost of capital while increasing access to capital for Spanish firms.

All indicators suggest that the Spanish financial market reforms have had a remarkable impact on restoring credibility and confidence in the banking sector. As an overview, interest rates have converged towards those of Germany, banks have recapitalized in order to pass European Union stress test benchmarks, and the banking sector is on its way to being cleaned up. Yet, Spanish banks are still holding a lot of bad assets on their balance sheets for fear of taking losses and the entire Spanish economy is in the process of deleveraging.

The Outright Monetary Transactions announced by the head of the European Central Bank, Mario Draghi, have been quite successful in lowering borrowing rates for Europe's periphery countries. Spain's 10-year treasury is down from a peak of 7.64% in July 2012 to 3.08% in April 2014.⁴⁰ Draghi has continued his rhetoric on lending countries 'whatever it takes', and he has even considered making the European Central Bank deposit rate negative to spur investment and inflation.⁴¹ The European Central Bank seems committed to providing countries with the proper access to capital while making sure banks are properly capitalized to reduce the chances of another crisis.

³⁹ Moffett, Matt. "Export Prowess Lifts Spain From Recession." *The Wall Street Journal*. N.p., 30 Oct. 2013. Web. . <<http://online.wsj.com/news/articles/SB10001424052702304073204579167141898123278>>.

⁴⁰ Bartha, Emese. "Bonds of Italy, Spain Narrow Gap with U.S., German Yields." *The Wall Street Journal*. N.p., 8 Apr. 2014. Web. . <<http://online.wsj.com/news/articles/SB10001424052702304819004579489033376330174?mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB10001424052702304819004579489033376330174.html>>.

⁴¹ Randow, Jana. "ECB Said to Consider Minus 0.1 Percent Deposit Rate." *Bloomberg*. N.p., 20 Nov. 2013. Web. . <<http://www.bloomberg.com/news/2013-11-20/ecb-said-to-consider-mini-deposit-rate-cut-if-more-easing-needed.html>>.

The plan of recapitalization of Spanish banks is currently on track. The initial reforms have created multi-year plans which include management overhauls, lending restrictions and cost cutting. Initially, ten banks were found to face capital shortfalls of €56 billion based on a benchmark of a 6% capital ratio. These shortfalls were mainly filled in the first quarter of 2013, 70% by public capital, 23% by junior debt bail-in, and 7% by private capital. Despite considerable progress, the banks still need to be cleaned up further, and in a follow-up action, capital requirements were increased to 9% by the European Commission to be enforced by the end of 2014.⁴²

The 'bad bank' SAREB is also on track, as the program has completed the transfer of assets, issuances of bonds and injections of capital. The Fund for Orderly Bank Restructuring, a government entity created to help the restructuring of the *cajas*, and the owner of 45% of SAREB, held 18% of total gross loans in all of Spain at the end of 2012. The government is currently divesting assets to private, international investors with the hope of finishing by the end of 2017. Catalunya Banc and Commerzbank AG are respectively marketing portfolios of €6.95 billion of residential home loans and €4.4 billion of commercial-property loans to investment banks and U.S. private equity firms such as Blackstone Group LP, Cerberus Capital Management LP and Apollo Global Management LLC.⁴³

Although SAREB estimates a loss in 2013, total cash flows exceeded operating expenses, and it was able to redeem some of its senior debt.⁴⁴ While the future profitability of the entity will depend on a housing rebound in Spain, prices for distressed real estate debt in Europe have been around 80 cents on the dollar, much higher than prices that investors normally pay for similar debt. European banks increased their sales of troubled debt by 40% in 2013, implying that at the current prices, the Spanish government may be profitable in the sale of the assets of SAREB.⁴⁵

Finally, structural reforms have remade the *cajas* system. On December 27, 2013 the Spanish government enacted *Ley 26/2013, de cajas de ahorros y fundaciones bancarias* to strengthen regulation for the savings banks by enhancing corporate governance and limiting the size and scope of the banks outside the native region.⁴⁶ Further, many savings banks were spun off as commercial banks before the reforms were instituted, and these commercial banks accounted for one-sixth of all assets of banks. The Spanish government has ensured that the new commercial banks were transformed into banking foundations over which the *Banco de España* has regulation. These

⁴² "Spain: Financial Sector Reform - Fourth Progress Report." . International Monetary Fund, 1 Nov. 2013. Web. . <<https://www.imf.org/external/pubs/ft/scr/2013/cr13331.pdf>>.

⁴³ Patnaude, Art. "Spain Launches \$9.6 billion Property-Loan Sale." *The Wall Street Journal*. N.p., 16 Apr. 2014. Web. . <<http://online.wsj.com/news/articles/SB10001424052702304626304579505523027510260?KEYWORDS=spain+frob&mg=reno64-wsj>>.

⁴⁴ "Spain: Financial Sector Reform - Fourth Progress Report." . International Monetary Fund, 1 Nov. 2013. Web. . <<https://www.imf.org/external/pubs/ft/scr/2013/cr13331.pdf>>.

⁴⁵ Glazer, Emily. "Investors Breathe Life Into European Banks' Bad Loans." *The Wall Street Journal*. N.p., 30 Mar. 2014. Web. . <<http://online.wsj.com/news/articles/SB10001424052702304688104579465903850501932>>.

⁴⁶ "Ley 26/2013, de 27 de diciembre, de cajas de ahorros y fundaciones bancarias." *Boletín Oficial del Estado*. N.p., 28 Dec. 2013. Web. . <http://www.boe.es/diario_boe/txt.php?id=BOE-A-2013-13723>.

foundations are required to describe ownership policies, hold investments in diversified assets, and hold a reserve fund of liquid assets.

Additionally, nonbank financing has strengthened. In December 2013, the first bond market for *pymes* (small and medium sized enterprises) opened. Throughout this year, hedge funds and private equity firms have increased their investments in Spain, offering banks a buyer for the troubled assets and offering *pymes* credit that is not available from Spanish banks, although at a much higher rate than before the crisis.⁴⁷

The financial reforms, with respect to the export-led recovery, were aimed at increasing credibility in the financial sector to decrease the cost of capital to companies. Yet, ironically, the deleveraging of the economy has created a dearth of capital in Spain. While Spanish treasury yields have converged toward those of Germany, the inexpensive capital has not reached small and medium sized companies, and the amount of net new commercial credit extended in Spain has decreased each of the past 5 years.⁴⁸

As seen in Figure 1, the cost of small loans in Spain is still very high compared to its European peers. While the spread between German and Spanish bonds is around 200 basis points, the spread between credit to small and medium sized companies in Spain and Germany is near 500 basis points. After implementing capital requirements, Spanish banks have been wary of extending loans of any type for fear of increasing their liabilities to unsustainable levels. Spanish banks have been additionally wary of loaning to small and medium sized businesses because of risk-weighted capital requirements. While loans to the Spanish government carries a low risk-weight, loans to small businesses are weighted much more, thereby increasing the capital requirements.⁴⁹ Now, growing small businesses cannot receive credit from banks at any rate, and are forced to look to European and American investment firms lending at a rate nearly 500 basis points higher than Spanish banks were before the crisis.⁵⁰ As a result, as seen in Figure 2, loans under €1 million to companies have

Figure 1

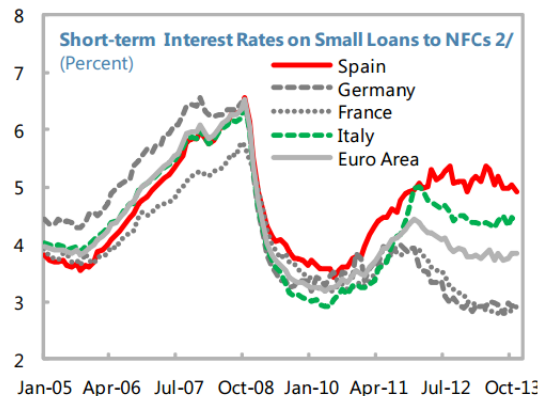
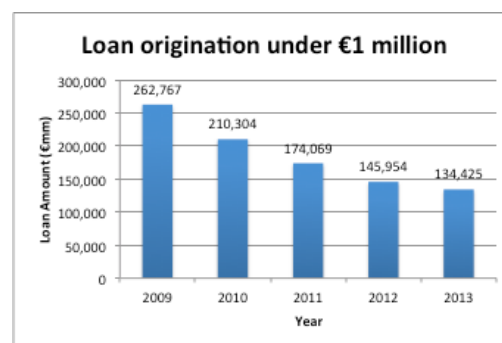


Figure 2



⁴⁷ Glazer, Emily. "Investors Breathe Life into European Banks' Bad Loans." *The Wall Street Journal*. N.p., 30 Mar. 2014. Web. . <<http://online.wsj.com/news/articles/SB10001424052702304688104579465903850501932>>.

⁴⁸ Lafraya, Conchi. "Las contradicciones del credito." *La Vanguardia* 7 Apr. 2014: n. pag. Print.

⁴⁹ "Spain: Financial Sector Reform - Fourth Progress Report." . International Monetary Fund, 1 Nov. 2013. Web. . <<https://www.imf.org/external/pubs/ft/scr/2013/cr13331.pdf>>.

decreased 49% since 2009.

Additionally, the Spanish private sector is in the process of deleveraging. As seen in Figure 3, throughout the crisis, the Spanish private sector became more highly levered than Italy, France, or Germany, peaking at above 200% of GDP in 2009. Companies experienced difficulty making debt payments during the crisis, and are now attempting to decrease the amount of debt on their balance sheets in order to improve their leverage and coverage ratios. Even though spreads on interest rates for large companies in Spain have decreased,⁵¹ few large Spanish companies are looking to borrow. As seen in Figure 4, in order to reduce the risk of bankruptcy and financial troubles in the case of another downturn, even the large companies in the Spanish private sector borrowed 57% less in 2013 than in 2009 to decrease the amount of debt it holds.

The combination of the deleveraging of the banking system with the deleveraging of the private sector has led to a high cost of capital for small companies in desperate need of capital, as seen by the 500 point spread between small loans in Germany and Spain, and low demand from the companies who can borrow at an attractive rate, as seen by the decrease in large loan origination of 57% over the past five years. As banks and private entities finish cleaning up their balance sheets, this trend has should bottom out by the end of 2014 and the reforms should have significant effects on the access to capital for Spanish companies.

Figure 3

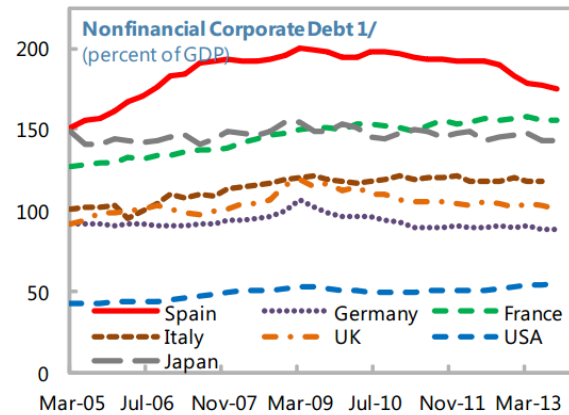
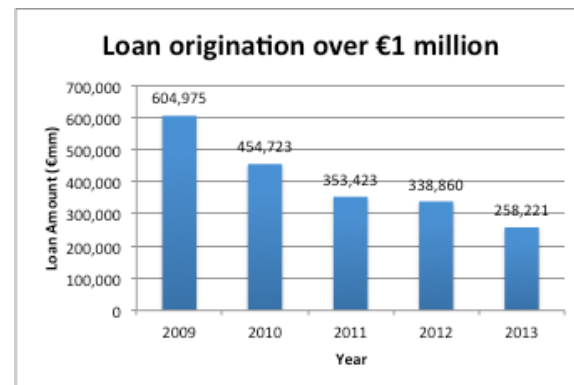


Figure 3



⁵⁰ Lafraya, Conchi. "Las contradicciones del credito." *La Vanguardia* 7 Apr. 2014: n. pag. Print.

⁵¹ "Spain: Financial Sector Reform - Fourth Progress Report." . International Monetary Fund, 1 Nov. 2013. Web. . <<https://www.imf.org/external/pubs/ft/scr/2013/cr13331.pdf>>.

Fiscal Measure Effects

The European Union placed austerity measures on Spain to increase confidence not only in the Spanish economy but also in the future of the EU as a whole. Spain has been diligent in decreasing its deficit to sustainable levels, and is seeing the benefits in international markets. The spending cuts and tax increases implemented by the Spanish government helped Spain decrease its budget deficit from 4.2% of GDP in 2012 to 3.9% in 2013. The European Commission has granted Spain a two-year extension, until 2016, to reduce its budget deficit to 3%, which it expects to accomplish.⁵²

Additionally, the autonomous regions have instituted reforms to lower their budget deficits. Between 2012 and 2013, the aggregate budget deficit of the regions dropped from €10.5 billion to €7.5 billion, a 28% decline.⁵³ Further, the regions are required to adjust their budgets by an additional €8 billion in 2014 and 2015.⁵⁴

There are many signs that the austerity measures have had positive effects on the credibility of Spain to the rest of the world. As previously mentioned, interest rates on Treasuries have decreased by almost 460 basis points since July 2012, and are only trading at a 30 basis point premium to those of the United States.⁵⁵ International investors have begun to take larger positions in Spanish companies,⁵⁶ as the Spanish stock market is up 68% from a low in April 2012 of 6,065 to 10,205 in April 2014.⁵⁷ In addition, Foreign Direct Investment increased 5% from 2012 to 2013, suggesting a willingness of foreign investors to take large positions in Spanish companies.⁵⁸ All three pieces of data seem to suggest that the austerity measures have been successful in creating a renewed sense of confidence in the Spanish economy.

⁵²"Stability Programme Update." *The Spanish Economy*. N.p., 1 Jan. 2013. Web. . <http://www.thespanisheconomy.com/stfls/tse/ficheros/2013/agosto/Stability_Programme_Update_2013_2016.pdf>.

⁵³"Presupuesto Generales de las Comunidades Autónomas." *Ministeria de Hacienda y Administraciones Públicas*. N.p., 1 Jan. 2013. Web. .

<<http://www.minhap.gob.es/Documentacion/Publico/PortalVarios/FinanciacionTerritorial/Autonomica/Resumen%20Ejecutivo%20Presupuestos/Resumen%20ejecutivo%20PRESUPUESTOS%20CC.AA.%202013.pdf>>.

⁵⁴"The Spanish Government imposes an €8 billion budget adjustment on the Autonomous Communities in 2014 and 2015." *Catalan News Agency*. N.p., 17 Oct. 2013. Web. . <<http://www.catalannewsagency.com/politics/item/the-spanish-government-imposes-an-8-billion-budget-adjustment-on-the-autonomous-communities-in-2014-and-2015>>.

⁵⁵*U.S. Department of the Treasury*. N.p., n.d. Web. . <<http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield>>.

⁵⁶Xydias, Alexis. "Spain ETF Grows as Rajoy Attracts Record U.S. Investments." *Bloomberg*. N.p., 16 Apr. 2014. Web. . <<http://www.bloomberg.com/news/2014-04-16/spain-etf-grows-as-rajoy-attracts-record-u-s-investments.html>>.

⁵⁷"." *Yahoo Finance*. N.p., n.d. Web. . <<http://finance.yahoo.com/q?s=%5EIBEX>>.

⁵⁸"Posición de inversión Internacional de España." *Banco de España*. N.p., n.d. Web. . <<http://www.bde.es/webbde/es/estadis/infoest/e0706.pdf>>.

Labor Market Reform Effects

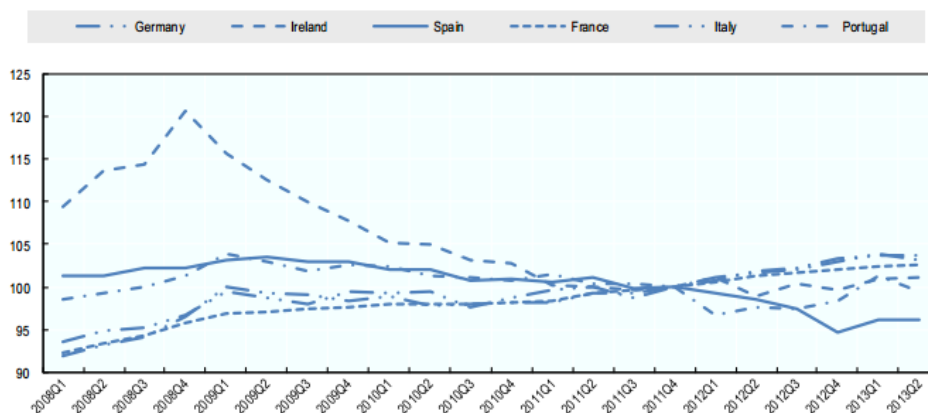
The effects of the reforms on the labor market seem to have been the most profound and direct in the landscape of the Spanish economy, although the data is limited to the 24 months since reforms began. Overall, unit labor costs have decreased, the hiring rate has increased, and small firm start-ups have increased.

Based on an OECD report in December 2013, unit labor costs have been reduced 3.9% in Spain between the fourth quarter of 2011 and second quarter of 2013,⁵⁹ although some of this number has to do with reducing public sector wages. The report estimates that the labor reforms induced a drop of between 1.2 and 1.9%. Additionally, the report estimates that the reforms increased the hiring rate by 8%, permanent contracts by 13%, and full-time open-ended contracts by 18%. Finally, the reforms are projected to have raised the share of exits from unemployment to permanent employment by about 14% and increasing small firm start-ups by 30%.⁶⁰

The labor reforms appear to have the most obvious and significant correlation to the export-led recovery. Because Spain cannot depreciate its currency to increase exports, it must decrease the price of its goods and services another way. By reforming archaic labor laws, Spain appears to have achieved a mechanism of decreasing the unit costs of labor and increasing productivity.

As seen in Figure 5 below, Spain has been able to decrease its unit labor costs relative to the costs in the fourth quarter of 2011, while its main competitors in the Euro area have been unable to do so. This decrease gives Spain a distinct advantage in the ability to lower prices of exports. Additionally, the productivity of Spanish workers has increased 1.2% compared to the Eurozone, mainly due to the relative ease of firing workers that the labor reforms have allowed.

Figure 4



⁵⁹ "The 2012 Labour Market Reform in Spain: A Preliminary Assessment." *OECD*. N.p., 1 Dec. 2013. Web. . <<http://www.oecd.org/els/emp/SpainLabourMarketReform-Report.pdf>>.

⁶⁰ *Ibid*

IV Effect of Reforms on Exports

The three areas of reform seem to have had a significant effect on their intended impact in Spain: driving an export-led recovery. Since the reforms were instituted in the second quarter of 2012, Spain has averaged 4.3% annual growth in exports, and has increased its share of exports to GDP from 31.6% to 34.6%.⁶¹ While many critics claim that exports have increased primarily due to the necessity of Spanish companies to look outside with the decrease of domestic demand, this section will present compelling evidence using comparable countries to suggest that the reforms have in fact led the export driven recovery.

First, to ensure that exports have increased in a substantial way since the reforms in 2012, the goods contributing to the increase were analyzed. Data on exports of goods was broken down by economic sector, and then contribution to export growth from 2012 to 2013 was compared to contribution of export growth from 2008 to 2013. This analysis should help to isolate which sectors were affected most by the reforms, specifically the labor reforms, beginning in the second quarter of 2012. As seen in Exhibit A, the contribution of capital goods grew to 53.9% from 21.5%, the contribution of automobiles grew from 3.1% to 34.0%, and the contribution of consumer goods grew from 10.9% to 17.5%. Conversely, the contribution of exports of energy decreased from 8.4% to -12.1%. Furthermore, the exports of services, which account for 32% of all exports in Spain, have increased 2.7% from 2012 to 2013, and within that, tourism has increased 3.9%.

The data shows that the increase in exports were in sectors where access to capital and labor costs are important. Additionally, exports of energy, a sector largely with high volatility due to market prices, actually decreased. This would suggest that the reforms have had a significant impact in increasing exports in Spain.

Next, to provide evidence that Spanish companies have not just increased their focus on exports, France and Italy will be used as controls. France elected Francois Hollande of the Socialist Party in 2012. During a similar timeframe as Rajoy's reforms, Hollande has allowed public spending to rise to the highest level in the Eurozone (57% of GDP), and has largely ignored pension reforms that are needed in France. He has not instituted labor reforms, and wages in France have increased since 2012.⁶² Italy, on the other hand, has had a fragile coalition at the head of its government over the past two years. The Italian government has had trouble passing any reform laws during the time of political gridlock.⁶³

⁶¹ Exhibit B

⁶² "Can Francois do a Gerhard?." *The Economist*. N.p., 11 Jan. 2014. Web. .

<<http://www.economist.com/news/leaders/21593456-president-talking-reform-it-his-interest-and-his-countrys-he-should-carry-it>>.

⁶³ Galloni, Alessandra. "Messy Italian Election Shakes World Markets." *The Wall Street Journal*. N.p., 26 Feb. 2013. Web. .

<<http://online.wsj.com/news/articles/SB10001424127887323384604578325992879185934?KEYWORDS=italy+gover nment&mg=reno64-wsj>>.

As seen in Exhibit B, the Spanish GDP has decreased an average of 1.1% since the second quarter of 2012, while that of Italy and France has decreased 0.8% and increased 1.3% respectively. These numbers show that domestic demand in all three countries has been weak, and all three countries, especially Spain and Italy, would have a strong incentive to attempt to sell products abroad. Meanwhile, Spanish exports have increased 4.3% during that time, while Italian and French have only increased 1.4% and 1.8% respectively.

Additionally, as seen in Exhibit C, 68% of Spanish exported goods go to European countries. While the GDP of European countries grew 0.8% between 2012 and 2013, Spanish exports to European countries grew 2.2% from 2012 to 2013.

While far from conclusive, this data suggests that the reforms implemented by the Rajoy government have had a significant impact in the export-led recovery of Spain. Italy and France are two countries with similar trading partners and economic conditions to Spain that have not instituted the level of reforms that the Rajoy administration has, especially with regards to increasing exports. Yet, despite similar domestic demand growth, especially with Italy, the exports of Spain have increased around three times the rate of Italy and France. Additionally, Spanish exports to European countries increased more than the GDP in those countries, implying that Spanish goods were more attractive in those countries. These two pieces of data show that Spanish products have certainly become more competitive in the global landscape, and the information presented earlier in the paper seems to connect this increase in competitiveness with the reforms instituted by the Rajoy administration.

While the initial results of the export led recovery seem promising, there are four key risk factors that exist that could change the fate of the Spanish recovery. First and foremost, there is no assurance that the Rajoy administration and the Popular Party will be reelected in 2015. Although 29% of people plan to vote for the Popular Party compared to 23% for the socialist workers' party (PSOE), two different parties, the United Left (IU) and Union Progress and Democracy (UPyD) have grown in popularity, each with an expected 13% of the vote. Both upcoming parties lean left on the political spectrum, and could cause difficulties in passing further reforms in Spanish, and, at worst, could reverse some of the reforms Spain has already made. Additionally, the approval rating of Rajoy is only 22%, above that of the PSOE leader (16%), but below that of the IU (23%) and the UPyD (32%) leaders.⁶⁴

Second, the ongoing secessionist movement by Catalonia has stoked concerns for the export-led recovery in Spain. The region with Barcelona as its capital has complained that the Spanish government takes a disproportionate amount of tax revenue from the wealthy region, and disrespects the Catalan language and culture. The risk is a serious one, especially considering 48% of Catalonians would prefer independence from Spain. In addition, while only accounting for 16% of the Spanish population, the region

⁶⁴ "Indicadores de opinion publica." *Simple Logica*. N.p., n.d. Web. . <<http://www.simplelogica.com/iop/iop14005-intencion-voto-popularidad-lideres.asp>>.

accounts for 26% of total exports.⁶⁵ Yet, the Spanish government has continually struck down Catalonia's attempts to call a referendum on independence, and the region would have difficulty pleading its case to join the EU if it did proclaim independence.

Third, Spanish exports are very dependent on the health of the Eurozone, and the global economy as a whole. While Spain has decreased its share of exports to the Eurozone from 57% before the crisis to 49% in 2013,⁶⁶ the region with negative growth in 2012 and 2013 and persistent debt problems still makes up a large share of its exports. Additionally, if global demand decreases, Spanish exports will likely take a hit, although the IMF predicts global GDP growth of almost 4% in 2014.⁶⁷ Overall, this risk factor is low because of Spain's efforts to increase exports to developing economies and the prediction that both the Eurozone and global economies will grow in the future.

Finally, Spain faces the risk of Italy and France, its direct competitors in many respects, instituting similar reforms to increase global competitiveness. Francois Hollande came out in the beginning of 2014 boasting his agenda to lower taxes and government spending while instituting reforms to increase competitiveness. While he has asserted such promises before, political experts say it is something that must be done if he wants to have a chance at reelection in 2017.⁶⁸ Likewise, Italy's new leader, Matteo Renzi, has also pledged a reform of tax and spending cuts, as well as a 10% cut in labor costs paid by the private sector. Similar to France's situation, the talk is there, but neither country has moved to take great action.⁶⁹ Currently, this risk factor should be seen as low for impeding the export-led recovery of Spain, but that could change if the Italian or French governments implement serious reforms.

Spain has taken impressive steps in restoring credibility and confidence in its economy, as well as increasing global competitiveness. The export-led recovery it has championed over the past 24 months to increase domestic demand and to decrease debt has been compelling. Backed by financial market reforms, fiscal measures and labor market reforms, Spanish exports have performed favorably in comparison to its direct competitors and neighbors. However, there are several risk factors that could hinder the recovery, chief among them the political landscape of Spain and the reaction of France and Italy. For the time being, Spain should expect its export-led recovery to continue, but should keep an eye out for the risk factors that could halt the recovery.

⁶⁵ "Informe mensual de comercio exterior." *Ministerio de economia y competitividad*. N.p., 1 Jan. 2014. Web. . <<http://www.comercio.mineco.gob.es/es-ES/comercio-exterior/estadisticas-informes/Paginas/Informes-de-Comercio-Exterior.aspx>>.

⁶⁶ Exhibit C

⁶⁷ "IMF World Economic Outlook." *International Monetary Fund*. N.p., 1 Jan. 2014. Web. . <<http://www.imf.org/external/Pubs/ft/weo/2014/01/pdf/text.pdf>>.

⁶⁸ "Can Francois do a Gerhard?." *The Economist*. N.p., 11 Jan. 2014. Web. . <<http://www.economist.com/news/leaders/21593456-president-talking-reform-it-his-interest-and-his-countrys-he-should-carry-it>>.

⁶⁹ Dinmore, Guy. "Italy's Matteo Renzi pledges tax cuts and labour reforms." *Financial Times*. N.p., 12 Mar. 2014. Web. . <"Can Francois do a Gerhard?." *The Economist*. N.p., 11 Jan. 2014. Web. . .>.