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Changes in the Spanish private sector: are they sustainable and has there been a change in the productive model?

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Theme

Foreign trade has brought glad tidings to the Spanish economy over the last decade, a period in which the country's current account has gone from being consistently negative to having a sustained surplus.

Summary

Foreign trade has brought glad tidings to the Spanish economy over the last decade. It is a period in which the country's current account has gone from being consistently negative to having a sustained surplus. The change is a result of an improvement in the competitiveness of Spanish exports, as well as a reduction in imports. Specifically, the surplus can be traced to a fall in the historically large deficit in the balance of goods and an increase in the surplus in the balance of services. Notable factors include a greater link between exports and global growth, less dependency on imports for domestic GDP growth, more exporting companies, diversification of markets, improvements in price-competitiveness and greater technological content in some shipments. In services, in addition to tourism, high added-value services are growing. Seeking to account for this more than likely structural change, various studies cited in this analysis suggest that the crisis forced many companies to export as a way of offsetting the decline in the domestic market, making them more resilient. Other research points to an increase in competitiveness and export capacity, with more internationalised companies. As this was happening with exports, imports fell due to the substitution of foreign products and a reduced preponderance of importing sectors. To conclude, the authors recommend consolidating the change in the productive model, given that exporting companies are more efficient and innovative and generate positive externalities. However, they also warn of the risks of a greater dependence on foreign markets amid deglobalisation and caution about the need to increase the complexity of exports, something that requires taking certain reforms further.

Analysis

Introduction

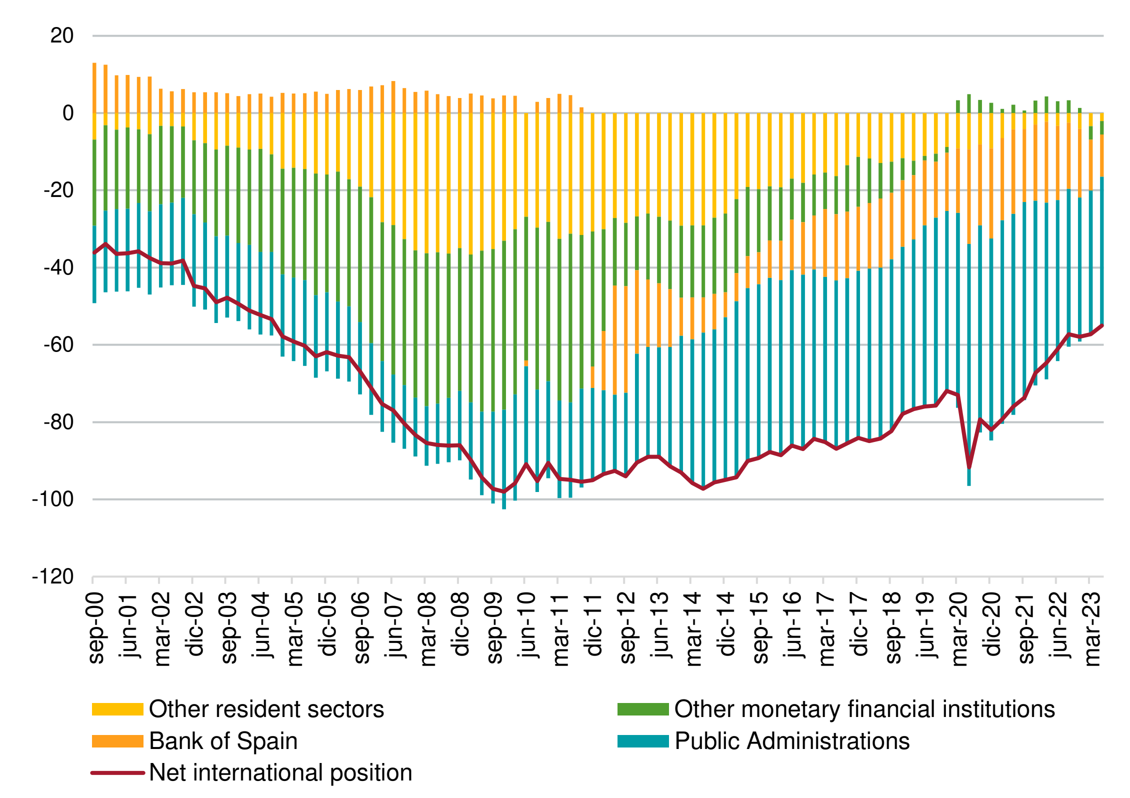
Spain once seemed condemned to having a permanently indebted foreign trade balance. Its current account recorded a positive balance in only six years between 1961 and 2011 and the surpluses were rapidly cancelled out. Something has happened, however, since the 2010-12 euro crisis, from which Spain, like other countries on the periphery of the Eurozone, emerged with a combination of austerity and an improvement in exports.

It has long been the case that the export sector sets off expansive cycles in the Spanish economy. What is new about the past 10 years is that, once the economy returned to growth and domestic demand increased, the current account did not revert to being negative, which would have been expected based on recent experience. Indeed, even in 2021 and 2022, and despite the hike in energy prices, traditionally one of the fundamental elements that has accounted for the current account deficit (especially in goods), the surplus has persisted, albeit reduced. And it did so despite Spain's membership of the Eurozone and thus the time-honoured lever of devaluation being unavailable.

The improvement in the current account balance is attributable to a series of changes that can be summarised as follows: first, the balance of payments figure is due to the conjunction of a fall in the balance of goods deficit together with an increase in the surplus of the balance of services. With regard to the former, the reduction in the deficit may be attributable to, among other factors, an increase in the link between Spanish exports and global economic growth and reduced dependency on imports for domestic growth. In addition to this there has been an increase in the number of exporting companies, a diversification of export markets towards countries with economic cycles that are less synchronised with Spain's, improvements in price-competitiveness and greater technological content in some of the exported products. In terms of the balance of services, in addition to tourism (where the surplus has continued to grow since the pandemic), some high added-value services play a prominent role, reflected in significant employment figures in sectors such as programming, architecture and engineering. Lastly, the trend in the capital account, boosted by enormous transfers from the EU's NextGenerationEU programme and other more traditional funds, has also strengthened the Spanish economy's financing capability. These factors explain the improvement in the Spanish economy's external position.

All this has placed Spain among the countries that have recorded the best foreign trade performances in the decade following 2011; in turn, this has enabled it to improve its net international financial position that, although still negative (and a source of external vulnerability), has notably improved (see Figure 1).

Figure 1. Net international position by institutional sector, 2000-23 (% of GDP)



Source: Bank of Spain, https://www.bde.es/webbe/en/estadisticas/temas/estadisticas-exteriores.html#

In light of the Spanish foreign sector's new landscape, the question is whether we are witnessing an anomalous decade or, on the contrary, Spain has undergone permanent change. If the latter, it would be useful to identify the causes that underpin this transformation: were they structural reforms? And in this case, what were they and when were they made? Did the behaviour of companies change? Did the number of exporting companies rise? Were productivity gains made? Etc. It would be even more useful to ascertain whether this change involves a new kind of national output, one that makes the Spanish economy more resilient to possible changes in the world economy, especially when we are witnessing a fragmentation of the global economy and a degree of deglobalisation.

This analysis is therefore split into three parts. In the first we delve further into the reasons accounting for the performance of the foreign sector, in particular its impact on the Spanish economy's current account and why the changes that have been witnessed have been both significant and positive. Next, we look at the main explanations that have been so far put forward to account for what has happened. Lastly, we make a series of recommendations to ensure that the achievements that have already been secured are not squandered.

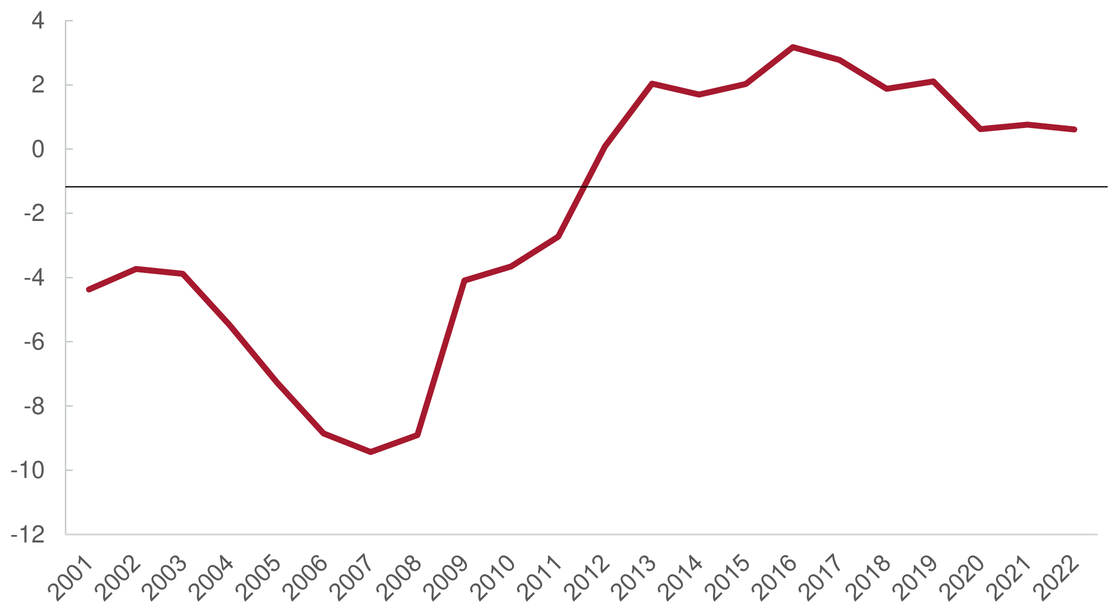
The change in the exports sector and its importance

According to data from the Bank of Spain, the evolution of the Spanish economy's capacity or need for financing between 2013 and 2022 was positive throughout the period except in 2018, the only year in which it declined slightly. This evolution stands in contrast to Spain's tendency to repeat a need for financing in most years since records began. A marked dependency on importing equipment and capital goods, as well as fuel, was not offset by the export of other goods and in particular services. In what appears to be a structural shift, this longstanding defect of the Spanish economy thus seems to have changed rather more than a decade ago.

This financing capacity was the result, however, of a combination of the deficit in the current account (need for financing) in most years, mainly due to the negative balance of goods together with a surplus in the capital account (capacity for financing) throughout the period under review. A prominent feature of the latter is the positive contribution of flows from the EU, especially in 2021-22.

The foreign surplus managed to exceed 3% of GDP in 2016 due to a good performance from services, tourism in particular, thereby offsetting the traditional deficit in the balance of goods, highly influenced by the negative energy balance.

Figure 2. Spain's current account balance (% of GDP)



Source: Bank of Spain.

A surplus in the current account is positive for a country's economy; first, because it involves a net inflow of currency, which swells international reserves. These reserves also enable investments to be made abroad, thereby improving the country's capacity for financing. Secondly, an excess of exports over imports increases domestic output and employment in exporting sectors and transfers foreign technology owing to the need to remain internationally competitive.

A surplus also enables a country to save instead of allocating scarce resources to imports, freeing up capital for investment in domestic output. It also induces other countries to have more demand for domestic assets, attracting investment from abroad. Lastly, a surplus in the current account reduces foreign debt, and with it the country's financial vulnerability.

In the case of Spain, the trade surpluses that have been consistently recorded since 2012 have brought ongoing respite compared with the fraught scenario that emerged in the decade preceding the bursting of the property bubble, transforming an economy with an enormous appetite for foreign financing, which hit 10% of GDP in 2007, into quite a different one with its own capacity, helping to offset the foreign imbalance and pay off some of the private debt accumulated in the preceding years. Evidently this improvement reflects the good export performance of such sectors as car manufacturing, agriculture, chemicals and machinery, with companies that have been able to make significant headway in global markets.

The foreign surplus has been key to the recovery of the Spanish economy in the wake of the financial crisis, especially by boosting output and employment. It has reversed the previous dependency on foreign financing and has improved the country's image as a recipient of international investment. It has also acted as a cushion against external shocks such as the COVID-19 pandemic and periods of financial volatility; this means Spain will start from a very different place compared with previous crises, something that may enable it to combat headwinds stemming from a possible economic contraction in a more positive way.

Deconstructing the changes in the export sector

Various studies have appeared in the last decade endeavouring to explain what underlies the 180-degree about-turn observed in Spain's foreign sector. In general terms, albeit using different analytical strategies and focusing on a variety of specific areas, the literature maintains that the foreign surplus stems from a clear improvement in the competitiveness of Spanish exports, accompanied by a fall in imports owing to reduced internal demand, especially towards the beginning of the last decade.

For example, Minondo analyses the possible causes for the improvement in Spain's foreign trade (here and here). He argues that exports and imports of Spanish goods are mainly determined by two variables: the income of Spain's trade partners and the price of Spanish exports compared with their competitors' prices. Thus, the higher our trade partners' incomes the greater the demand for Spanish products will be abroad. And the cheaper Spanish exports become compared with products exported by other countries the greater Spanish exports will be.

The interesting point to note is that, traditionally, the sensitivity of Spanish exports to our partners' growth has been pronounced, but the sensitivity of Spanish imports to Spanish growth was higher. Therefore, faster growth in the Spanish economy compared to European countries was formerly accompanied by a deterioration in the current account balance; this has not been the case since 2015, which suggests there has been a structural change.

This is precisely what emerges from the analysis conducted by Azón (2018), which shows that between 2008 and 2017 there was an increase in the sensitivity of Spanish exports to the growth in global income and a reduction in the sensitivity of Spanish imports to growth in the Spanish economy. This structural change thus brings to an end the traditional imbalance exhibited by Spain over the course of decades. For the first time, and particularly during the second half of the last decade, Spain succeeded in growing more than its European partners without this causing a deterioration of its trade balance, the starting point of successive corrections for the Spanish economic cycle. Spanish companies have thus shown great ability to compete in international markets and significant resilience in the face of crises.

But understanding why this change came about requires a differentiated analysis of the dynamic in the growth of exports, and why imports did not grow as they had formerly done once the economy recovered starting in 2015. Any analysis of exports must therefore try to explain Spanish companies' increase in export capacity to the rest of the world in a context that differs from previous decades. Might it be that Spanish companies' competitiveness has increased and with it their export capacity? Did these same companies 'discover' their export capacity when the domestic market collapsed in the wake of the property crash? In both cases, what factors shaped companies' capacity (competitiveness) in order to sustain Spain's export capacity year after year?

As already mentioned, one of the factors that could contribute to this change in the balance of Spain's current account is an increase in companies' ability to compete in international markets. Thus Lucio, Mínguez, Montiel & Requena (2017), focusing on exports for the 2010-20 period, show that there was a 42% increase in the number of companies that export on a regular basis. These companies have exported uninterruptedly over the course of at least four years and were responsible for 94% of the exports of Spanish goods in 2020. The report's authors argue that the growth in the number of regular exporters may be attributable to the Great Recession and not just to the increase in price-competitiveness stemming from a possible reduction in salaries and unit labour costs. A possible explanation would emerge from the effort that many of these companies have put into exporting in the years following the Great Recession in order to make up for the drop in domestic sales.

This finding is extended in the work of Eppinger, Meythaler & Sindlinger (2015), who analyse Spain's international trade before, during and after the 2008 financial crisis using company-level data. What the authors find is that the crisis did not have a negative effect on companies' entry and exit into and from foreign markets. In fact, after the crisis there was a greater proportion of companies that immersed themselves in international trade, diversifying their exports towards more distant destinations outside the EU. Moreover, companies that were exporters prior to the crisis were more resilient during the recession than those that sold only within the domestic market. In particular, the exporters saved more jobs, remained more productive and had greater chances of surviving. Non-exporting companies by contrast suffered a significant deterioration in their total factor productivity, which fell by 22% between 2007 and 2011, whereas the exporting companies had similar levels of productivity in 2011 to the one that they had in 2007.

In their study based on analysing the commercial transactions of Spanish import-export companies, Lucio, Mínguez, Minondo & Requena (2011) examined the contribution of intensive and extensive dimensions to changes in trade over the 1997-2007 period. By an extensive dimension the authors refer to changes in the numbers of companies, products or trade partnerships, whereas an intensive dimension is taken to refer to variations within existing trade relationships.

The authors use a decomposition method to analyse temporal variation, conducting comparisons with similar research in other countries. The results reveal that, in the short term, the variations in the average value of the transactions of the existing trading relationships were the main influence on trade flows, whereas over the long term the entry of new companies was a key factor. They also looked at the differences in the trade flows between trading partners and products, exploring whether these were due to differences in the number of participating companies, the number of products sold or the average value by company.

Meanwhile, various studies suggest that exports can help to counteract the negative impact of turbulence in internal demand in a domestic recession. Authors such as Almunia *et al*. (2021) point out that Spanish manufacturing companies, whose domestic sales fell during the Great Recession, underwent a greater increase in their exports. Such evidence shows that there existed a capacity among Spanish companies to counteract the negative effect of fluctuations in local demand. This result suggests that when domestic demand falls, companies can resort to export markets to offset the loss in sales. It is obvious, however, that for this to work there need to be certain factors in place to ensure that resorting to foreign markets is feasible.

Lastly, in terms of imports, as the Bank of Spain points out, there may be two reasons that explain the fall in the sensitivity of imports to GDP growth in Spain. First, Spanish products have replaced imported products in all the components of final demand (consumption, investment and exports) owing to their being more attractive and competitive, in part thanks to a differential evolution of prices in Spain's favour. Secondly, it has been possible to reduce the weight of final demand components with a greater export content (investment), in favour of components with a lesser importation weight (final consumption).

Conclusions

Lessons for the future

The analysis of the preceding pages suggests that there is indeed a structural change taking place in the Spanish economy that, if it takes root, will put an end to the current account deficit that has beleaguered it for decades and caused significant vulnerabilities, above all in terms of requiring permanent foreign funding and increasing the Spanish economy's liabilities abroad.

However, this more export-driven growth model, akin to that of countries such as Germany and the Netherlands, also incurs certain risks given the current international context involving fragmentation of the world's economy and deglobalisation. It should not be forgotten that greater dependency on foreign markets may entail greater vulnerability to growing protectionism, the return of geo-economics, trade wars and the weakness of the multilateral trade system, its rules and its predictability (this happened during the COVID-19 pandemic, when the Spanish economy suffered more than others with the sudden suspension of tourist travel). Indeed, the EU is expending ever more effort in underpinning its economic security, reducing risks stemming from economic interdependence and achieving greater strategic autonomy.

In any event, bearing in mind that more than two thirds of Spanish exports go to other EU countries (and are therefore not subject to these geopolitical and regulatory headwinds), the increases in both the number of exporting companies and in the volume exported are good news for the Spanish economy. Indeed, the most internationalised companies have major advantages over non-internationalised ones. They are larger and produce a greater quantity of goods and services than those operating exclusively in the domestic market. By virtue of being larger they can take greater advantage of economies of scale and have greater financing capability, which in turn enables them to make larger investments. The knock-on effect is that they devote more resources to R&D, are more innovative and are more used to operating in highly competitive markets, meaning that they are more efficient and reach notably higher levels of productivity than non-internationalised companies. Furthermore, such companies tend to create more employment, attract better-qualified workers thanks to the fact they pay higher salaries, they have more and better ongoing training programmes for their employees, they recycle their workers more efficiently and they are capable of developing a global mentality that facilitates their adaptation to new settings, facilitates creativity and their workers' acquisition of skills and makes them more competitive in their home markets. For all these reasons, internationalised and exporting companies withstand recessive phases of the economic cycle better, in terms both of output and employment. By having higher levels of productivity and being able to diversify their risks more, offsetting the fall in sales in one market with higher sales in others, they have a lower 'mortality rate' than companies operating only in the domestic market. Lastly, international activity generates a large number of positive externalities, both over other companies and over the country as a whole. Thus, the technological innovations that such companies produce tend to filter through (sometimes slowly, owing to the protection afforded by patents) to other sectors, they fuel demand for other companies to which they contract out intermediate supplies and, in general, they pay more taxes than smaller companies less geared towards the foreign market.

However, by way of a qualification to all that has been set out above, it should be pointed out that this process of searching for foreign markets has been accompanied by a reduction in the complexity of Spanish exports. The recent Cotec report states that, over the last decade, in comparison with other European countries, Spain has slipped down the ranking of exporters of sophisticated goods and has made no headway in the export of goods that are only exported by the most technologically advanced nations. It is precisely the greater internationalisation of Spanish companies, penetrating with an extensive expansion in already-known markets with relatively low technology (as well as the boom in exports of some low added-value services such as tourism) that could account for this situation.

For all these reasons, it would be advisable for the Spanish economy to continue on the reforming path of recent years to consolidate this Copernican shift in the performance of its foreign sector. Indeed, as mentioned, the challenge continues to be that of increasing even further the level of complexity of Spanish exports, which is still relatively low compared with those of our European partners and paradoxically has not improved in recent years. The rapid implementation of the Recovery Plan investments and reforms funded by the EU, which offer significant incentives for both public and private actors, continue to be the main tool for achieving this objective.