Venting out: the Spanish export miracle

By Miguel Almunia

What drives businesses to sell their products in foreign markets rather than in the home market? This long-standing question is at the core of our understanding of international trade.

STUDENTS OF INTRODUCTORY ECONOMICS learn that each country exports the products that they are relatively better at producing. That is, countries specialise according to their comparative advantage. Interestingly, Adam Smith – the so-called "founder" of economics as a science – had different ideas.

In *The Wealth of Nations*, he wrote: "When the produce of any particular branch of industry exceeds what the demand of the country requires, the surplus must be sent abroad, and exchanged for something for which there is a demand at home." This was later called the "vent for surplus" theory, which does not refer to comparative advantage in any way. Smith's early followers dismissed it as a mistake of the master, and it has been largely ignored in the subsequent research on international trade.

However, it appears that Smith's hypothesis could help explain some recent phenomena, such as the Spanish "export miracle" of the last decade. Few countries experienced the negative consequences of the Great Recession as intensely as Spain. From its peak in 2008, Spain's real Gross Domestic Product (GDP) fell by an accumulated 9 percent until bottoming out in 2013, when the unemployment rate skyrocketed to over 26 percent. Despite this massive domestic slump, Spanish exports demonstrated an amazing resilience during these years. After the shock of the global trade collapse of 2009, Spanish merchandise exports quickly recovered. Exports grew by almost 40 percent between 2009 and 2013. Spain outperformed other euro-area economies. This resulted in an increase in the market share of Spanish merchandise exports to non-euro-area countries, despite the simultaneous decline in the relative weight of Spain's GDP as shown in Figure 1.

In recent research, Pol Antras, David Lopez-Rodriguez, Eduardo Morales, and I focus on the Spanish case to study whether the dramatic shock to the domestic economy was in fact one of the causes of the export boom.

Two lines of thought have emerged as the leading explanations for the Spanish export miracle. Some attribute the export boom to a process of "internal devaluation", whereby fiscal austerity and labour reforms (approved in 2010 and 2012) would have reduced wages and improved the competitiveness of Spanish firms. A second explanation relates the spectacular growth in exports directly to the collapse in domestic demand: faced with excess capacity during the domestic slump, Spanish producers were forced to step up their efforts to seek new customers in foreign markets. This second explanation is essentially the "vent-for-surplus" argument proposed by Smith.

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The two explanations are not mutually exclusive. However, the link between a domestic slump and export growth is hard to reconcile with standard models of international trade. These models assume that each additional unit produced always has the same cost, which implies that a firm's sales at home and abroad should be independent from each other. In other words, standard trade models are inconsistent with the intuitive notion that a drop in domestic demand (keeping the cost of workers and inputs fixed) might lead some firms to attempt to recoup part of their lost domestic revenue in foreign markets.

The challenge of our empirical exercise is that we don't observe domestic demand shocks directly, only domestic sales. Estimating the effect of domestic sales on exports with a simple statistical analysis would bias our estimates We address this issue in two ways: first, we isolate demand factors by taking into account determinants of firms' supply, such as productivity and wage costs. Second, we use a measure of local demand, the net purchases of vehicles, as an instrument for domestic sales. This means that we effectively use the demand for vehicles as a proxy for the domestic demand for other manufacturing products.

We find that, when local demand falls by 10 percent, firm exports increase by about 11 percent. Note that this does not imply a one-to-one substitution in monetary values. The typical firm in our sample has an export share of 20 percent, so revenue from domestic sales is four times larger than revenue from exports. Thus, if firms lose €100 of domestic sales, their exports increase by, on average, €25.

With these results, we estimate what share of the export boom can be explained by the "vent for surplus" channel, compared to other channels. We find that this share is substantial and could be powerful enough to explain more than half of the growth in Spanish exports in the period from 2009 to 2013, although the precise number depends on several assumptions. Due to data limitations, our analysis examines optimal allocation of productive capacity to the domestic market and to a single (representative) export destination. In future work, we plan to expand this analysis to a multi-country environment to better understand the role of increasing marginal costs in shaping the response of firms when they experience shocks in the world economy.

Does Adam Smith's largely dismissed "vent-for-surplus" theory warrant reappraisal?

Is the spectacular growth in Spanish exports tied directly to the collapse of domestic demand?

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Figure 1: The Spanish export miracle

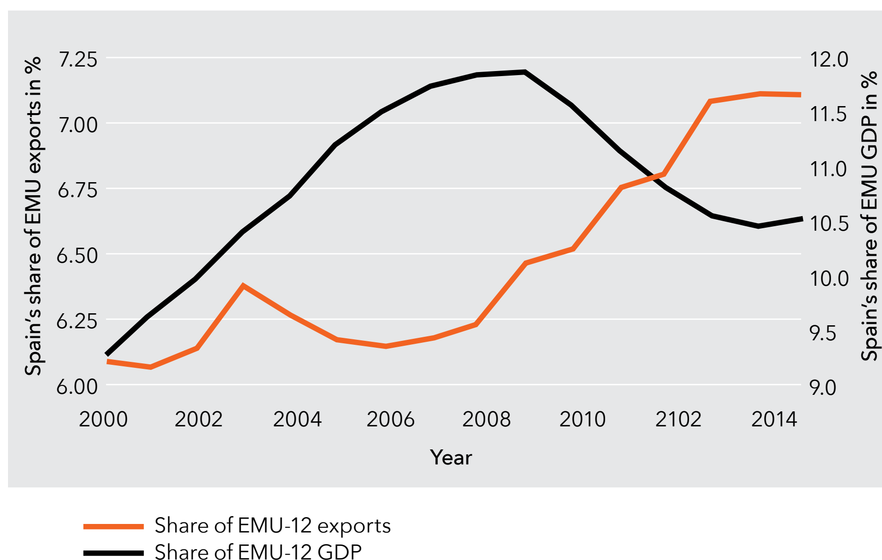
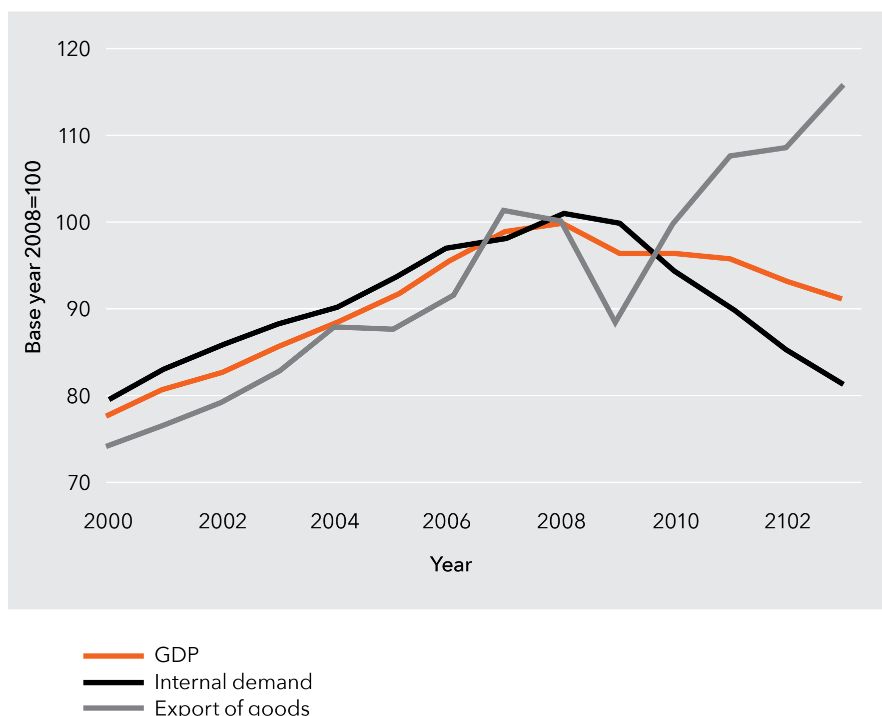


Figure 2: The great recession in Spain



Do standard trade models get it wrong? Does a slump in domestic demand lead firms to try to recoup some domestic revenue losses in foreign markets?