

Crisis and crisis.

The Spanish economic crisis and the world crisis: two different crises not to be confounded

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We are living times of great economic turmoil. News of crisis all over the world succeed each other. Being integrated in a world economy, it would be very comfortable to think that it is excess related to subprime mortgages in the United States what has dragged us into the crisis, and that now everything depends on big international summits – no matter if Spain is there or not – to find a way out of it.



We are not all the same

The authors would like to point towards the fact that the Spanish crisis – and thus the one we are suffering in Catalonia – is very different from the international financial one. So it would be wrong and dreadful not to take specific measures addressed at internal problems in Spain and wait for the world to solve the situation instead. If we do not acknowledge it and act accordingly, there is a serious risk that once the global economy takes off again, we stay alone and with no help.

We will now explain in detail our concerns, which are long-standing in the sense that even when the economy was doing well, we were warning that despite going at a strong pace, its direction was wrong. In this respect, we are going to use some old references to illustrate the assertion that the problem is neither new nor circumstantial.

The Spanish and the international crisis have one same origin: living beyond own means. In the international case, it was basically the financial system that, joining crazy incentive schemes – that did not converge top manager interests with those of organisations and their stakeholders – and tricky instruments – which did away with transparency and ensured impossibility to figure out the risk and real value of things, with the aid of ICT – originated a magnificent bubble, perfectly described in that joke about herring boxes.¹ However, in the Spanish case, the main problem lies in that we have been living beyond our means in recent years, like those new money who suddenly notice that they have depleted all their wealth.

In this article we will focus on domestic problems, leaving aside the international crisis.² We would only like to point out that both crises became synchronised – as is obvious – when the strong Spanish debt urging banks to raise funds abroad met a lack of resources due to missing liquidity in the international financial system. This burst the bubble, a bubble that was

different from the one bursting in other countries, though there are many analogies with some specific cases.

What were we doing badly in?

For quite a long time, one could have the impression – based on both economic figures and the opinion of Catalan entrepreneurs – that the Catalan economy³ (and also the Spanish) were doing quite well. Surprisingly well.⁴ During recent years, growth had been high (more than elsewhere in Europe), many jobs had been created, people were consuming, businesses were profitable, exports were growing and the stock exchange was rising. In a word, it could not be said that the economy was doing badly.

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Certainly, an economy can do very well for a certain time without any governmental input, mainly out of two reasons:

- ▶ To the vast majority of companies, the role of public authorities is irrelevant in the short term except in tax matters, fixing the cost of some inputs (energy, water, etc.) and regulation (labour, safety, environment, etc.).
- ▶ Public policies have a medium and long-term effect (be they related to infrastructure, education or competitiveness properly as described in SUBIRÀ and GURGUÍ, 2007).

So the Catalan economy was doing well as a result of deep change in the whole country over the last twenty years minimum. However, possible inefficiency – or incompetence – necessarily claimed its toll at a given moment, and now we got there.

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So the economy was doing well. However, some indicators suddenly appeared that were pointing towards a possible change of cycle:⁵ at international level it was the US mortgage fund crisis; in Spain, the loss of momentum in the building branch, which had been playing an excessively leading role in recent growth. The rise of interest rates, with their impact on the purchasing power of families and thus on consumption,⁶ also had to do with it.

In our opinion, the real risk factors were others, particularly evolution towards an economic model with low productivity, little value creation, low salaries and strong external imbalance, while collective awareness of the problems this meant was absent.

In the following we will analyse the main symptoms and aggravating factors.

Stagnation of productivity

This is the true crux of our problems, the synthesis of all evil and the absolute priority of what needs to change in the future. This extreme weakness has been pointed out on countless occasions.

Taking productivity per employed person as a reference, the Spanish growth rate of this indicator has always been below 1% ever since 1995, with some years even in the negative,

while the European yearly average was 1.7% and the US rate 2.3%.⁷ However, labour costs increased 27% between 1999 and 2007, as opposed to a 14% average in the eurozone.⁸ Spanish economic growth occurred based on employment increase, not on improved productivity as is the case of the most developed economies.⁹ This has allowed to integrate the massive migration wave without becoming a time bomb in the light of the change of cycle. And the worst may be yet to come, as not only have low-skilled jobs been created but also top-end ones destroyed, i.e. the most qualified ones, especially in manufacturing. The result of all this is that there are increasingly more people on €1000 salaries and more wasted university graduates. By and by we have become a low cost country in all respects: little requirements, little ambition. That is, mediocrity at all levels, which is a suicidal attitude within a context of economic globalisation. Only excellence will be honoured in the future.

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Differential inflation

The inflation rate in Catalonia has systematically been above Spain's, which in turn was one point higher than the European average. This means that our products were losing between 1 and 2% of their competitiveness related to our main competitors, namely the rest of Europe.¹⁰ This is extremely concerning, added to poor growth in productivity. Products have become more expensive or profit margins had to be cut, which has pushed many Catalan entrepreneurs to sell their company to invest in real estate. So Catalonia has not only sold less but it has also lost many companies.

In the short term, inflation can be due to many phenomena, like the evolution of the oil price in specific moments. However, in the medium

and long term, inflation, especially differential inflation compared to other economies is a symptom of a more fundamental imbalance: expenditure above wealth creation. To use a business metaphor, Catalonia plc is a company having shareholders, both Catalan and non-Catalan, who systematically withdraw an amount of benefits higher than what the company's profit margin allows, and reinvestment of the required portion of this benefit in the own company is little and poor: this is Catalonia's chronic tax deficit.

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In such a context, a company would implement a drastic policy to reduce expenditure, besides being very careful to make sure that investment is justified by their mere contribution to future activity growth. But in Catalonia we have no problems with adding more inefficiency and burdens to our productive system so the cost everybody has to bear increases.¹¹ Besides, different non-productive units of Catalonia plc absorbing large resources – public authorities – inflate their staff and are spending ever more and worse.¹² All this fosters systematic price growth above that of our competitors.

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The euro-dollar exchange rate

Catalonia's foreign market is heavily dependent on Europe, but to grow it should clearly go for diversification all over the world. However, such a policy became almost impossible with the evolution of the euro-dollar exchange rate, which reached 1.5 when not a long time ago, one dollar had been worth more than one euro. It is not the first time such strong oscillations occur (let us remember that in times of the peseta, the dollar went up from 60 to 180 and back down to 80), which also have most likely to do with policies imposed by American interests. Anyway, in recent years this factor has made life difficult for Spanish and Catalan exporters, especially the latter.

The inevitable loss of relevance of manufacturing

In November 2005, the relevance of manufacturing in the United States was for the first time in history under 10% as of total employment. This is a steady trend that is not to be interpreted as a loss of relevance of industry but as an effect of a change in the structure of the value chain: automation – replacement of labour by investment – process outsourcing, change of product types (computer games instead of physical toys), move of manufacturing to areas with lower salaries, etc. In any case, with Catalonia being an industrial area and given the fact that many of the best qualified jobs are in this sector, this evolution, which is much more serious than it should be, exposes Catalonia to the risk of increasing drift towards a low-value service economy. In this respect, the call of former president Pujol – «Do not close the factories!»¹³ – becomes a dramatic priority.

Foreign trade deficit

Together with differential inflation, deficit is the other clear manifestation of imbalance between wealth creation and expenditure, and nobody can say that this problem only came up with

the crisis.¹⁴ After spectacular evolution of Catalan exports in the 1980s and 1990s, in which Catalan business had been able to adapt to the global economy, the trade balance has been deteriorating in recent times, with import growth rates systematically above export ones. If we add the erosion of competitiveness due to these factors, bleak perspectives of an enormous deficit that is already being generated are becoming ever worse. Besides, the traditional equation had been deficit = imports - exports - tourism. Now, increasingly relevant remittances by migrants are to be added to it.

Catalonia's trade balance is deteriorating, with import growth rates systematically above export ones.

Further additional problems

Finally, the lack of entrepreneurial awareness of our governments at any level is dramatic. This is shown both in aesthetically attractive but hardly justifiable directives and in problems created by many city councils to create and grow businesses. Unfortunately, this is a problem shared by both big parties (socialist PSOE and conservative PP) in Spain. We only need to look at the position of the then conservative government related to the takeover bid of Iberdrola by Gas Natural, an operation with a great sense of entrepreneurship that would have spared many problems that came later. In that moment, Madrid gave priority to «power» over national interests. Government action that disregards the economic effects of its measures will hardly contribute to a country's competitiveness.

Another serious error in Spain in recent years has been to disregard a very significant part of the best human capital it had and to lose the knowledge of thousands of skilled labour in a certain age. Massive early retirement carried out in many industries has led to waste a large proportion of the best talent and experience.

As the new money do, the best and most valuable furniture has been taken for outdated stuff and replaced by Ikea articles. Consequences are appalling. For instance, the finance sector has been left without experienced risk appraisers, people able to separate the wheat from the chaff and adequately assess an individual company apart from business press news. A part of the credit crunch problem some companies are suffering – which may lead them to shut down – is that the one deciding on renewing a credit policy is a young person with a brand new MA who read that the car industry is in crisis and takes a short cut giving a negative credit report, while ignoring completely that they are dealing with a good customer of the bank, with an immaculate long-standing record and no delinquency of any kind.

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In all this, we also see a crisis that is not crisis but simple landing. Regarding housing and building, did anybody really believe that a building pace above that of all big European countries taken together was sustainable? Now it comes out that there is almost one million – or one million and a half, according to the source – of housing units on sale! Unfortunately, this will cause quasi-inactivity for some years in the branch and related ones, and here government action can have most effects through public works, as long as it adds value for the country and makes it more competitive. Otherwise it will be a waste of resources.

Equally worrying is to state that new generations are increasingly inclined to humanities when choosing their professional career. Young Catalans wish to be journalists rather than physicists, and civil servants rather than entrepreneurs; this is a problem to be solved.

What do we need to do?

The above-mentioned imbalance is difficult to solve. Living beyond one's own means or having expenditure grow faster than wealth creation used to be solved with penitence by devaluating the currency. Now we are in the euro, this is not possible anymore. However, measures are urgently needed to stimulate domestic activity and penalise purchase from abroad; this can partly be done through taxation. Personally speaking, the authors advocate major restructuring of taxes and duties, such as a strong reduction of corporate and income tax, compensated by a VAT increase. Also some concepts such as double compensation out of redundancy payment needs to be rethought as there are already unemployment benefits; instead, it has been announced that from September 2009 over 300,000 people will not be covered by any such benefit in Spain.

The authors advocate major restructuring of taxes and duties, such as a strong reduction of corporate and income tax, compensated by a VAT increase.

Measures like a VAT increase are certainly inflationary, but so is devaluation. Besides, price increase is mitigated by reduced income tax retention, which raises net salaries for employees. It is possible that the biggest current risk is deflation together with salary agreements featuring an already subscribed increase, so the negative impact of such a measure would be very limited.

Also, gradual reduction of the taxation burden is urgent in order to return to 2003 figures. This is thought to be unfeasible amidst a crisis, considering the public expenditure increase this means, but oversizing of the public sector as we are having it now, with several redundant administration levels, bodies devoid of competencies, etc. is a luxury this country cannot afford.

It needs to be said that the international crisis, besides having triggered our own one, has frozen other threats. On the one hand, it set an abrupt end to oil price escalation that was rushing to the \$200 mark at a frightening pace; on the other, it reduced the euro-dollar rate that had posed so great difficulties to exports outside the eurozone. We need to take advantage of this break to implement measures that allow to catch up: starting off economic productivity, deepening internationalisation of our economic fabric, including R&D&I massively at all levels, improving education, recovering effort and excellence as values, recovering saving as a habit, etc.

This serious crisis requires bold measures. Faced with severe illness, nobody expects the doctor to prescribe dinner at a top restaurant but certainly unpleasant treatment. Citizens will be therefore grateful to politicians talking clearly and doing realistic, specific proposals instead of a shopping list full of useless bits and pieces. Hence trust is to be generated, which will be impossible if public authorities do not start applying these recipes on themselves: payment in due time, commitment to drastically downsize the public sector, etc.

«What I am worried about is not that you lied to me but that from now on I will not be able to believe in you again.»

Friedrich Wilhelm Nietzsche

A journalist from *El País* newspaper wrote recently (5 November 2008, p. 13): «*Now the tsunami unleashed by subprime mortgages has fully hit Spain, sweeping away as many as 200,000 jobs in a single month.*» Sorry, but not. These jobs have gone lost due to our own weakness and the mistakes made in recent years. The crisis should also serve to start taking our own responsibility. Both the economic problem and others such as education or justice will only be solved when those involved stop shaking off the blame. The new president of the United States won the elections with the slogan «yes, we can». We must remember that «we» includes, first and foremost, the one saying it.

«We always have the impression that we could improve what others do, but never what we do ourselves.»

Emil Cioran, Romanian philosopher

We pretended to be the greenest – subsidies to renewable energies in 2009¹⁵ will cost each family more than €200 – the most solidary and the most egalitarian – we are the only country of the world giving free access to health and education to everybody¹⁶ – but we forget that this is all very nice, but it needs to be paid, and the only way to do so is creating enough wealth at the required pace. The situation can become even worse, given that much excess in recent years has been diluted thanks to massive input from European funds that allowed to disguise a vast number of inefficiencies. For all of Spain, the same can be said of Catalan «solidarity», which has played a similar role. On one side,

Spain does not receive any more European funds as of today, but on the other, Catalan tax deficit is increasingly unbearable and will lead the Catalan economy to bankruptcy if it is not halted – an outright stalemate that cannot be solved without extraordinary political courage. Will it be possible?

«An optimist sees an opportunity in any calamity, a pessimist sees a calamity in any opportunity.»

Winston Churchill

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**Reference**

SUBIRÀ, A.; GURGUÍ, A. (2007). *Políticas para la competitividad*. Barcelona: Antoni Bosch Editor.

Notes

1. Herring boxes double their price in each transaction. The last buyer, thinking that they must be excellent – considering the price he paid – finds them rotten.
2. Cf. interview with Gary Hamel in this *Paradigmes* issue.
3. Presentation of the 2006 data on the Catalan economy by minister Castells on 24 March 2007. Cf. e.g. *El País*, p. 36 from the same day.
4. Presentation of the 1st quarter 2007 data by the Instituto Nacional de Estadística on 24 May 2007. Cf. e.g. *El Periódico*, p. 46; *El Mundo*, p. 50 or *El País*, p. 91 from the same day.
5. Presentation of the 3rd quarter 2007 data by the Instituto Nacional de Estadística, on 14 November 2007. Cf. e.g. *Cinco Días*, p. 43; *El Periódico*, p. 46 or *Expansión*, p. 40 from the same day.
6. «“The Party is Over” . A Special Report on Spain». *The Economist*, 11 November 2008.
7. Cf. e.g. *Expansión*, 29 January 2009, p. 47.
8. *The Economist*, 3 January 2009, p. 51.
9. While Spanish productivity was virtually stagnating – slight increase in industry and reduction in services – it had been growing at a yearly average 10% in South Korea since 2002 («Special Report». *The Economist*, 27 September 2008, p. 7). Also cf. e.g. *El País*, 5 September 2005, p. 56.
10. On 12 December 2005, *Cinco Días* was already warning that «since Spain entered the European Monetary Union, its inflation rate has accumulated a differential of 12.5 points compared to its partners, which has led to a relative loss of competitiveness above 10%. Appreciation of the euro has aggravated the loss of competitiveness as compared to the USA or Japan, at 35% and 65% since 2000, respectively.» It is an old quotation, yet fully valid.
11. Who will pay for the Endesa farce, just to put an example?
12. Cf. e.g. *ABC*, 30 January 2009, p. 37 or *Expansión*, 21 November 2008, p. 38.
13. Cf. <http://www.jordipujol.cat/ca/jp/articles/5457>
14. «Un desequilibrio de récord mundial». *El País*, 21 October 2007, p. 4.
15. *Expansión*, 11 November 2008, p. 3.
16. *El País*, 18 February 2009, p. 27.