Observations about the Spanish Economy

Eduardo Aguirre
United States Ambassador to Spain, 2005-2009

"Our relationship with Spain needs to improve…fix it!" That was the main theme of my Oval Office meeting with President George W. Bush before I left for my post in Madrid in 2005. The president had reviewed a draft of my list of priorities in Spain and agreed with its substance. He also underscored the issues that were more important to him, injecting personal observations, and a few choice colorful words, that as a fellow Texan, I had no problems understanding.

The president stated that Spain was important to the United States, but he had not forgotten the sudden withdrawal of Spanish troops during the Iraq war, ordered by President Zapatero just days after being elected. President Bush understood that President Zapatero had campaigned on such an action and that political campaign promises had to be honored. However, he thought the sudden execution of this withdrawal was inexcusable, effectively opening an ill-timed breach that could potentially result in unnecessary military risks, thus further placing Coalition forces in harm's way.

That day, I walked out of the Oval Office with the clear purpose to find ways to reduce tension, find common ground with the Spanish government, and normalize our relationship. My main strategy was to focus our attention on matters of common strategic importance—security and economic cooperation.

Bilateral and Multilateral Issues

Since that day, it seems to me that the key bilateral and multilateral issues remain about the same. Then and now, our two countries continue to share common goals and perspectives on a multitude of fundamental issues of bilateral importance, including:

- National Security (including combating terrorism, narcotics-trafficking, organized crime, human trafficking, transportation safety, sea container security, illegal immigration, money laundering, cyber crime, and criminal extraditions)
- Intelligence development and cooperation
- Mediterranean security, naval and air base activities
- Defense cooperation including military sales, technology transfers, and licensing
- Commercial, trade, and economic interests; customizing support for US and Spanish companies with their cross-border expansions

Bilateral direct investment is worth special mention: a few years ago the US Embassy ranked Spain as the 11th largest investor in the United States and the second fastest growing source of foreign direct investment in our country. The Embassy also highlighted that the US business presence in Spain was strong, representing seven percent of Spain's GDP. Over 650 US firms in Spain employ more than 300,000 workers.

Of course, there are also many multilateral and regional issues important to our two countries, but the item that most dominates our current attention is the trials and tribulations of the Spanish economy.

Observations about the Spanish Economy

In the seesaw of media attention, Spain appears to constantly show up at the extremes—way up or way down. During my time as US Ambassador to Spain from 2005 to 2009, Spain was generally perceived by many to be a country of strong and sustainable economic vibrancy. Its 30 percent GDP growth between 2000 and 2008 was impressive by any standard. Then, seemingly in the blink of an eye, the tenor of the news flipped. For the past five years the Spanish economy has been widely reported to be on a rapid downward trajectory. Examining key events in the past that created the present situation will help us to determine what the future may hold for Spain.

After Francisco Franco's economic and political isolation ended in the 1970s, Spain experienced a decade of economic problems. Spain, which at the time imported 70 percent of its energy, was particularly vulnerable to the two oil price shocks of the 1970s. Eventually, by 1985, Spain's economy began to grow and inflation rates were controlled.

It may be helpful to recall that, for a variety of reasons—including Franco's demonstrated fascist leanings—Spain had been bypassed by the post-World War II Marshall Plan, Europe's infrastructure repairs, and the new building bonanza that extended well into the 1950s.

In the Cold War era of the late 1950s and 1960s, the Spanish Peninsula was recognized to be a logistically strategic location; US administrations began to relax certain isolationist tendencies, receiving in return military air and sea bases, as well as some ancillary infrastructure latitude. Still, Spain was ill-prepared to share in and fully benefit from Europe's economic expansion of the 1960s. By the mid-1970s, Spain's economy and overall standard of living had fallen significantly behind its European neighbors.

The post-Franco era was full of structural changes for Spain. In 1976, a democratic constitutional monarchy was instituted, King Juan Carlos I was installed as the new head of state, and Adolfo Suárez González was elected prime minister and head of government. A few years later, under the leadership of President Felipe González, Spain astutely negotiated entry into NATO and then into the European Union. Shortly thereafter, Spaniards saw an increase in construction, and they quickly got used to the prevalent sights of earth-moving equipment and building cranes. Thus began an economic and building renaissance, punctuated by a primary focus towards upgrading an obsolete and dysfunctional road and rail infrastructure. One early beneficiary was Spain's agriculture sector, which then could begin to transport more efficiently its produce to domestic and international markets.

Spain's civil engineering and construction-related companies shone brightly during this period, growing in size and knowledge along the way. They eventually became world-class companies capable of successfully competing, *mano-a-mano*, with their international peers. The second construction boom followed those early civil engineering and infrastructure efforts; this time, with a focus on building and housing construction, it impacted almost every city and region of the country.

Over the course of the following three decades, the European Union would eventually transfer significant funds to Spain. Precise numbers are hard to find, but it's estimated that the European Union provided Spain with aggregates of anywhere from €150 billion to €1 trillion. That considerable transfer of wealth funded Spain's government-sponsored construction revival. By 2008, sophisticated toll roads, cantilevered bridges, complex tunnels, state-of-the art airports, world-class sea ports, hyper-speed trains, and fancy train stations had been inaugurated at breakneck rates. The local and international banking community competed against each other with abundant construction loans and mortgage financing, proudly perfecting public-private partnerships (PPPs) to enhance the financing equation. Unemployment was statistically non-existent; prosperity and the feeling of good fortune were very palpable at restaurants, shopping malls, car dealerships, vacation destinations, golf clubs, and many others.

When the financing supported growth stopped in late 2008, coinciding with the worldwide economic crash, Spain was significantly overbuilt, marked by infrastructure projects, unsold housing, and excess inventory in anything related to concrete, steel re-bar, and bricks. As the construction industry abruptly stopped, and the subsequent ripple effect spread to other industries, a drastic increase in unemployment followed, eventually idling one out of four employable Spaniards, with an acute concentration among the younger segment of the workforce. It's worth remembering that at its peak in 2008, the construction industry accounted for 22 percent of Spain's economy and 14 percent of total employment. Adding tangential industries to the equation, the number would easily surpass one-third of the Spanish economy. Such dependency on one sector made Spain vulnerable to an abrupt transition from excess to restraint.

With that background as a primer and, as 2014 gets underway, I see promising signs that the Spanish economy touched bottom late last year and has started a rebound. Barring unforeseen new domestic or global issues, Spain seems to be at the beginning of a gradual turnaround. Granted, it will take a number of positive fiscal quarters to persuade investors that a sustainable trend exists. Hopefully some structural changes implemented by the current administration of Prime Minister Mariano Rajoy will give Spain a good chance to reboot the economy with a broader and more diversified economic base.

Changes in employment laws will make it easier to rationalize new hiring by wary employers. Employers should now be able to better grow or shrink their workforce in response to business opportunities without pre-crisis constrictive rules that made it financially prohibitive to reduce their fulltime workforce. The new labor laws may be welcomed by international business leaders interested in entering the EU economy through Spain.

This past February I spent a week in Madrid visiting with Spanish captains of industry and finance, and learning of their continued commitments to grow and invest in the United States, Mexico, and the rest of Latin America. While I found some cautious optimism for investing in Spain, Spanish multinationals uniformly asserted their intention to continue solidifying, and in some cases expanding, their corporate grasp beyond the geographic and economic boundaries of the Iberian Peninsula.

If Spain begins an economic recovery, the Spanish government would be well advised to promote policies that encourage a diversification of the economy beyond the construction industry. Spain has a well-educated population with a tradition for good productivity and respect for the rule of law. Yet, sometimes Spanish laws and practices are not too encouraging to the high investment industries that depend on structural protection of intellectual property.

Improvements can continue to be made to Spain's structural legal protection of intellectual property. Investors in sectors such as pharmaceutical research, genetic engineering, software development, security technology, and aerospace innovation find Spain intriguing not because wages are cheap, but because the available workforce is composed of well-educated and well-motivated candidates who would much prefer to stay and work in Spain, rather than seek their future and fortune in other parts of the world.

As highlighted in a recent publication by the American Chamber of Commerce in Spain, another bright star in the economic diversification horizon is growing the country's increasingly strong export economy. From the manufacturing sector (capital goods, food, chemicals, and automotive industries) to the service sector (tourism, transportation and communication), strong exports have swung the balance of trade in Spain from a large current account deficit, to a likely surplus in 2013. Much remains to be done to maintain and expand market share in such a competitive sector, but the foundation exists for future growth and development.

Cautiously, Spain's Ministry of Treasury forecasts that it will take another three years before the Spanish economy reaches the economic figures seen in 2008, with unemployment remaining in double digits for the rest of this decade.

An obvious question is what will happen to the surplus inventory of finished and unfinished commercial and residential real estate developments? It's not a secret that a myriad of investors, large and small, have been "kicking the tires" of the available inventory. Portfolios at banks and Cajas are still saturated with non-performing loans, which in turn are collateralized by devalued non-productive assets. Prospects abound for opportunistic investors who seek favorable risk-reward ratios. So far, few deals have gone forward; however, one senses that the race is about to start.

Conclusion

After an intensively busy week in Madrid with dear friends, who also happen to be business leaders and government officials, I returned home to Houston with the following fresh impressions:

- Spain's economy may have lost a bit of its shine; however, it still ranks 13th in the world.

- Spain's political landscape is relatively stable, in contrast to the constant political turmoil of countries like Italy, Turkey, and Greece. One lingering question concerns the vital region of Cataluña. Nationalistic sentiments there have flared up and, so far, the central government has dealt adroitly with the prickly issue. Time will tell which side of reason prevails.

- Economic sectors such as exports, research, development and innovation (R&D/I), and others, hold medium and long term promise—particularly, if the government creates incentives for expansion, and stronger intellectual property protections.

- Considering the economic bleakness of recent years, the future holds much promise, and I can see many opportunities waiting to be seized by bold investors. Indeed, the risk/reward ratio seems favorable to me!

- Spain has a bright future as the source of corporate international expansion into the United States, Mexico, and the Americas. Conversely, American companies should continue to view Spain as a European business destination, finding there a well-educated and well-motivated workforce, along with the business advantages of entry into the European Union.

One final personal observation, during my four years as Ambassador I developed wonderful friendships and strong feelings of affection for Spain, a country that I learned to appreciate, and grew to love. Since leaving post five years ago, those feelings have strengthened and the personal bonds will last a lifetime.