Spanish Economy: Numbers vs Reality

Richard Jungwoo Hong

UPenn, Wharton
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Abstract
The European economy has been struggling with their debt level since the 2008 financial crisis. Unlike United States whose centralized government play a key role in reverting economic downturns, there is no quantitative easing or definitive centralized authorities in the European Union who can single handily stop the downward economic spiral. To analyze how detrimental the economic conditions are in Europe, personal interviews, data collection and primary research have been conducted to take a deeper dive into how the European economy operates. In addition, the analysis will cover in more depth about how Spain – known for being one of the most fragile economic powerhouses in Europe – has recovered in a much quicker pace, and how its economic figures don't explain the entire story. Debt levels, corporate indices, macroeconomics and most importantly, culture play a vital role in how Spain is coming back from its heavy economic pressure.

Keywords
Spain, economy

Disciplines
Business
ABSTRACT

The European economy has been struggling with their debt level since the 2008 financial crisis. Unlike United States whose centralized government play a key role in reverting economic downturns, there is no quantitative easing or definitive centralized authorities in the European Union who can single handily stop the downward economic spiral. To analyze how detrimental the economic conditions are in Europe, personal interviews, data collection and primary research have been conducted to take a deeper dive into how the European economy operates. In addition, the analysis will cover in more depth about how Spain – known for being one of the most fragile economic powerhouses in Europe – has recovered in a much quicker pace, and how its economic figures don’t explain the entire story. Debt levels, corporate indices, macroeconomics and most importantly, culture play a vital role in how Spain is coming back from its heavy economic pressure.
INTRODUCTION \ purpose

The purpose of this research proposal is to uncover the economic conditions and the recovery status of the European economy. Through detailed interviews, primary data analysis, economic research and cultural intuition, the European economies will be compared side by side to analyze debt levels, corporate performances, and the underlying cultural differences that may put the economic figures in perspective. The Spanish economy – characterized by a recent positive return in the debt market – will be scrutinized to uncover its culture and why the numbers don’t necessarily reflect the underlying realities.

INTRODUCTION \ methodology

Several methodologies of analyzing economic conditions of Europe:

- Interviewing professors, professionals and citizens about the economic downturn
- Do citizens know about the economy and what are they doing about it?
- Do cultural differences in each country tell a different story than the numbers?
- Do presence of start-ups and venture capital help innovation and economic stimulus?
- Analyze the amount of financial damage for worst case scenario of each of these countries.
**THE EUROPEAN ECONOMY**

The European Economy never really escaped the 2008 global financial crisis. In order to finance the economic stimulus packages, and bail out banks that were on the verge of bankruptcy, most European countries had to spike up their ratio of government debt in comparison to their GDP – from 66% to 93%\(^1\). Although high government debt is not necessarily an impediment to economic growth, it does become very difficult for the government to service that debt with such high interest rates in the future. A notable case is Greece in the chart below who nearly have 175% government debt to GDP ratio.

What is more alarming around Europe is that the majority of economic difficulty stems from Southern Europe where the spike in manufacturing labor rate is far beyond the normal mean at nearly 20.40 Euros per hour as opposed to Poland who is only at 6.90 euros per hour.\(^2\)

The Eurozone has been working on drafting an economic policy across all European nations to limit the government borrowing to merely 3% of their economic output. However, this has been proven to ineffective as similar rules that have been set up in 1997 – when the Euro was created – was consistently broken, notably by Italy, Germany and France.\(^3\) The reason why

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southern European countries such as Italy and Spain are suffering more extensively than others is because of their instability and high interest rates – as noted by the graph.

The main derivers behind why Spain, France and Italy are suffering more than others can also be attributed to their disproportionate amount of private debt that exist in their countries. After Euro was set up in 1997, many of the southern European countries enjoyed low interest rates, which made obtaining capital very easy, resulting in extraordinarily high amounts of debt very quickly.

One of the reasons why Germany ended up performing so well is because the rising wages and easy capital in Spain, France and Italy increased spending and imports. Germany took advantage of this economic growth by increasing its exports, keeping the surplus cash and made sure that the wage remained steady.

+ THE EUROPEAN ECONOMY \ current status

Consistent meetings among Eurozone members have not reached any major milestones, but the “Latin Bloc” – France, Spain and Italy – have forged a coalition that are attempting to limit Angela Merkel’s governance over their countries. Currently, the solution being drafted is the banking union – a commonly issued Eurozone bonds – that will intervene directly in the financial markets “to buy the bonds of troubled countries”. However, Germany wants political power over their neighbors in return for economic insurance.  

In addition, the falling ruble crisis in Russia adds to the uncertainty factor in Europe. For example, France has over 59.2 billion dollars exposed to Russia in debt while corporations such as the Deutsche Bank have over 5.2 Billion euros in Russia. Such uneasiness has been unexpected and will be covered in next year’s agenda.\(^5\)

Low growths around all European countries have created a difficult global recovery. Even other parts of the world – such as US, UK and China – have all seen their exports decrease as their major trading partners begin to spend less.\(^6\) The only exception to this trend is Germany who has been growing in exports as their competitive labor rates and healthy corporate structure keep them afloat in comparison to their European neighbors.

During the Great Depression, United States initiated a strategy known as “beggar thy neighbor”, and it centralized on devaluing its own currency to stimulate domestic production and increase net export. However, such technique cannot be executed in the European Union, and while the Euro has devalued nearly 25% against the dollar, most of the benefit is reaped by Germany who outcompete other countries due to its competitive labor rate.\(^7\)

THE EUROPEAN ECONOMY \ recovery

The decision going forward is a very tricky one. Spain, Italy and France have already suffered a huge increase in their labor wage, meaning their exports are not competitive and employment rate will begin to burgeon. Because it is hard to reverse labor wages – mostly due to political outcry and protests, there only remain two options for the European countries to take action:

- **Cut Spending** - This means that economy will continue to falter as less spending means higher unemployment rate, less jobs and economic stimulus. This may decrease the labor wages to make the exports much more competitive, but such decision will only be effective in the long run. However, it does avoid the chance of default on debt.

- **Keep Spending** - The burgeoned debts in the European governments make it already hard for many investors to stay at ease. More spending will likely mean more debt, and this runs into a risk of the market losing its confidence in the country’s ability to pay. Especially because other European countries don’t have the money to bail another Eurozone country out, this can lead to a significant risk of default, pushing foreign and domestic capital out of the market.

The Euro currency was designed to protect all economies from foreign interruptions and keep stability, but such stability comes at the cost of flexibility. Because many of these countries cannot perform techniques such as quantitative easing, it makes it difficult for them to “climb” out of the economic downward spiral.
Government Debt Level in comparison to GDP

Corporate Debt in comparison to GDP
**ECONOMIC COMPARISON**

**stocks**

**CAC 40** – French Stock Index | 10 Years

**GDAXI** – German Stock Index | 10 Years
**IBEX – Spanish Stock Index | 10 Years**

**FTSEMIB – Italian Stock Index | 10 years**
In many cases, culture plays a vital role in productivity and survival. Because culture is so crucially important, several key interviews – from a venture capitalist to a small business owner – have been conducted to take a deeper dive into how the Spanish do business.

Spain has a sense of accomplishment more than other parts of Europe. Alex Chueh – a former venture capitalist in Singapore and an engineering graduate from Penn – indicated that there is a culture of entrepreneurship in Barcelona that makes it an ideal place to start a new venture fund. He indicated that Spain is making a comeback, and the bigger enterprises are starting to bounce back into a healthy economic status. However, he does insinuate that in order for this to be sustainable, there must be more capital lent out to medium and small sized enterprises. These small businesses are the backbone of the Spanish economy, and over 62.8% of the employed populations are financed by enterprises with 1 – 50 employees.

Alex also adds that venture capital money has not yet been pumped into the Spanish economy, and any European expansion tends to start with London or Berlin. However, good pool of talent and the hunger for new innovations can serve as an impetus behind future venture capital boom in Spain. Spain also has its own internal control issue. Struggling with mistrust from its own citizens, Spain also has a problem of illegal immigration from northern Africa who put overburdening cost of healthcare,
transportation and other universal welfare. The main key of why Spain is doing better than its ridiculous unemployment rate is the strength of family businesses and relatively high disposable income due to family expense sharing.

The difference between United States and Spain is quite enormous. Rajneeth Kapoor – a Wharton graduate, a former entrepreneur, and a restaurant owner in Spain – explains the public’s disdain towards government officials. He indicates that social security for labor is extremely high (at nearly 45%), and government tend to mismanage much of the money it collects due to heavy lobbying and strong ties to the private industry sector. Many mistrust the government of misallocating the fund for this reason. He also emphasizes the emotional impact of the recession even today. People tend to prefer take-outs, prepackaged meals and are very sensitive to any price increases in the restaurant business. He explains that more than half of the restaurant business in Barcelona has closed down while the other half are operating under illegal hires, tax delays or family members operating the business. However, he also insinuates that the concept of independence is new in Spain, and familial bond is very strong, which lessens the burden of having to pay rent, groceries and utilities – especially for the younger generation. He also indicates that the culture is the reason why small to medium size businesses work well against the recession and also why it is a better fit for the Spanish economy. Family ties promote better communication and stronger trusts among employees, and it is somewhat “recession-proof” as family members are willing to work for much less than the market price in order to sustain the business.

The culture is work hard, play hard in Barcelona. Carlos Garcia Pont – a marketing and management professor at IESE Business School – indicates that the crisis in Spain is almost over. Statistics indicate good consecutive jumps in GDP, and they are now in a better shape when it comes to bond yield rate, especially compared to Germany. The biggest thing fueling Spanish economy is the cultural and familial ties. However, Professor Pont indicates that there are too many government decision makers, which makes it hard for businesses to understand what regulations and tax procedures to follow. The Spanish citizens strive for a Franconian approach and deregulations, but to put things in perspective, the French law for businesses tends to be
even more barring towards new businesses, impeding innovations and foreign capital. He also indicates that Spain’s multi-cultural regions and languages can serve as a divider but also cultural and economic diversity.

New businesses are hard to come by. Because innovations are not as developed as United States, social media marketing, user acquisitions and platform technologies are simply nonexistent in Spain. Because of this, Juan Capel—a small business owner in the plumbing business who lives in Barcelona—insinuates how relationships are the main key behind the Spanish economy getting by. He states that he had to layoff many of his workers, but the reason why his business is still standing is because of his past relationships and excellent services to his clients. In addition, he indicates that there is an influx of capital coming from foreign investments and tourism because warm weather and beach front properties in Spain still remain very attractive to other Europeans, notably Russians and Germans. Juan employs over 5 of his family members out of 10 employees that he currently has in his company. He attributes much of his success to direct communication, trust and flexible hours that are only possible between familial relationships.
Although Europe is struggling through its economic recovery and much of the decisions in the near future will shape their economic fate for the next decade, a majority of the economic figures cannot wholly explain the underlying realities of the countries. Economic policies, macroeconomic trends and most importantly, cultural strength of these countries will determine their economic resiliency. At the end of the day, it’s the people who make up the society, and while economic figures can partially represent the country’s financial health, it is the culture that defines and heals it.
+ ADDITIONAL INFORMATION \ appendix

+ ADDITIONAL INFORMATION \ acknowledgments

Alex Chueh | Enspire Capital | Singapore, Singapore
Carlos Garcia Pont | IESE Business School | Barcelona, Spain
Rajneeth Kapoor | Mayura | Barcelona, Spain
Juan Capel | Capel Plumbing | Barcelona, Spain