

CLUB SIGLO XXI

***THE WAY OUT OF THE CRISIS AND THE
CONSTRUCTION SECTOR***

TALK GIVEN BY
MR. JUAN-MIGUEL VILLAR MIR,
CHAIRMAN OF THE VILLAR MIR GROUP

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Mr. Miguel Rodríguez-Piñero, President of the Club Siglo XXI.

Ladies and Gentlemen.

Friends, all of you.

It is an enormous satisfaction for me to be here today with all of you at the Club Siglo XXI, an institution created in 1969, of which I have the honour to be a founding member; the only one, in fact, who is still among the ranks.

During its forty-year lifetime, including Spain's years under the Dictatorship, the Club Siglo XXI has always been an open forum for debate and the exchange of ideas. It has always been an anticipator of the future, with a long and prestigious tradition of talks and discussion-dinners, which have earned it widespread recognition as representing one of the best barometers of cultural, political and social activity in Spain.

And the satisfaction, the enormous satisfaction, of taking part in this important open platform, had been intensified today by the very laudatory and very kind introduction made of me by the outstanding scholar and excellent entrepreneur of the legal profession, Antonio Garrigues Walker, one of the most international, knowledgeable and prestigious of our contemporaries, on a Spanish and world scale.

My deepest appreciation to the Club Siglo XXI for having me here today and to you, Antonio Garrigues Walker, for your introduction. And thank you all for your attendance.

My talk today, *The Way Out of the Crisis and the Construction Sector*, addresses the subject which, without a doubt, constitutes the primary concern of Spaniards overall and the basis of our daily discussions. One could write not only a whole series of talks but also several books on this subject.

In order to make an orderly presentation of so broad a subject, I will devote the first few minutes to recalling the causes of the world crisis, with particular emphasis on Spain and its construction sector. I will then go on to examine the current situation of the economy, worldwide and on the level of Spain. Following this, I will analyze the measures to be adopted, both immediately as well as in the long term, in order to emerge from the crisis. And I will conclude by explaining the well-founded reasons which, in my opinion, should support our confidence in overcoming the situation of crisis which we are experiencing today, and in overcoming it quickly.

1. Causes of the world crisis

Let us begin with a brief overview of the causes of the crisis on a world level.

August 2007 marked the onset of one of the worst financial crises in the history of the world economy. Its origin can be found in the confluence of three circumstances:

- An excessively expansionary monetary policy.
- The inadequate regulation of the financial sector in the United States.
- And the high degree of financial innovation in the first few years of the 21st century and the inadequate practices of many banks, also in the United States, with excessive assumption of risk.

In the face of the Year 2000 economic crisis, intensified by the terrorist attacks of September 11, 2001 in the United States, Central Banks around the world reacted with an expansionary monetary policy and interest rate cuts which, in the absence of inflationary tensions, were maintained on very low nominal levels –around 2% in the eurozone, 1% in the United States and close to 0% in Japan– during an excessive period of time.

The maintaining of very low interest rates over a lengthy period of time and the enormous expansion of the monetary mass associated with such policy were conducive to the formation of property bubbles and credit bubbles in many countries throughout the world.

In the United States, where inadequate regulation allowed this situation to occur, many financial institutions changed the traditional framework of the banking business, in order to take advantage of the enormous opportunities for generating profits in the short term, offered by the situation of economic bonanza and superabundance of credit.

They therefore designed a new business model consisting of the securitisation of mortgage loans, their packaging in structured assets and their subsequent sale to other investors; and it is in this process -and off-balance sheet- where the obtaining of higher profits resided, instead of in the conventional loan business.

At the same time, there was an expansion of a mortgage lending market called *subprime mortgages*, on account of their low or very low quality, stemming from the fact of being granted in excessively high amounts and often to borrowers of doubtful solvency. This

segment increased to the extent where it accounted for approximately 15% of the U.S. mortgage lending market overall.

When in 2006, the expansionary phase of the economic cycle came to an end and the decline commenced, housing prices began to drop and many of these borrowers with low solvency stopped making their mortgage payments. And, with the onset of the crisis in August 2007, the prices of these structured assets collapsed and, with them, the value of the asset and of the net worth of the financial entities holding securities of this kind in their portfolios.

Many banks in the United States and in Europe sustained heavy losses, driving them to the edge of insolvency or even in a situation of bankruptcy, and the interbank markets came to a standstill. The crisis was intensified as of September 2008, when the bankruptcy of Lehman Brothers placed the world financial system on the verge of collapse. And all of this combined to make the intervention of Governments and Central Banks necessary, in support of financial institutions in a good number of countries.

As a consequence of the decapitalisation of balance sheets, derived from the losses suffered in this process and from the difficulties in obtaining liquidity, financial institutions had no option other than to stop granting loans to companies and families. In this way, the financial crisis was transmitted to the real economy and transformed into a profound economic crisis, which has been christened as the "Great Recession", a name parallel to that of the "Great Depression", which had devastated the world economy in the thirties following the outbreak of the great financial crisis of 1929.

2. The crisis in Spain and the construction sector

In Spain, the origin of our economic crisis is partially internal, with the bursting of our own property bubble and due to the loss of competitiveness of our economy.

In effect, in our country, three crises coincide and combine their consequences:

- The world financial crisis, the worst since 1929.
- Our own property crisis, having built, year after year during a period of over five years, approximately double the housing units needed to meet a sustainable demand.
- And the crisis, also intrinsically Spanish, of the loss of competitiveness of our economy, with accumulated effects due to wage and inflation excesses during a decade, starting in 1999 when we adopted the Euro.

Our construction sector played an excessively leading role in the lengthy phase of economic expansion initiated in the mid nineties and ending in 2007. Over the last few years of that period, the Gross Added Value went on to account for 11% of GDP, in comparison to rates of around 6% for the average of the European Union.

In the course of that enormous expansion, the level of employment in our construction sector jumped from 1.1 million jobs in 1995 to 2.6 million in 2007, whereby 23% of the total employment created from 1995 to 2007 in the Spanish economy overall was generated in the construction sector, and this figure does not include the employment induced in other economic sectors connected with construction.

The excessive development achieved by the construction sector in Spain was partially healthy, to the extent that it was an outcome of the intensive stimulus to investment in infrastructures. With the help of the large amount of structural funds originating from the EU, which reached a point where they accounted for as much as 1.5% per annum of our Gross Domestic Product, public works received a considerable boost during those years, enabling us to reduce the gap that separated us from our wealthier Community partners in terms of infrastructures.

The beneficial effect of this component of construction activity is unquestionable, as is also the need to maintain its pace of growth in the future, considering that investment in

infrastructures is a fundamental springboard to the development of countries and a basic condition for increasing competitiveness and the growth capacity of the economy. And, therefore, thanks to the stronger investments made, infrastructures in recent years are no longer a drain on, but rather are beginning to become a stimulus to economic progress and competitiveness.

However, unfortunately, the greater part of the oversized construction sector in Spain stemmed from the excessive volume produced by the housing construction activity. In Spain, an enormous speculative bubble was generated in the property market, of proportions far beyond those experienced in other countries, as a consequence of the fact that the interest rates determined by the European Central Bank, which between 2003 and 2006 were negative in real terms, turned out to be much too low for an economy such as the Spanish economy, which was growing at a stronger pace than the average for the eurozone.

Between 1996 and 2007, investment in housing grew at a real average rate of 7%, in comparison to the 2% registered in the EU overall and in contrast to the 3.9% increase in our country of investment in the other areas of the construction sector taken overall, according to figures provided by Eurostat. Investment in housing in Spain in 2007 accounted for half of the total investment in construction, while in 1995 it represented only one-third.

In the last few years of the period, investment in housing went as far as to account for 9% of GDP, in comparison to percentages of 5.8% in the EU overall or the 4.4% which such investment represented in our country in the mid nineties. Thus, more than 30% of the total investment in our country went to housing.

The number of housing starts per year, which between 1980 and 1996 ranged around 250,000, shot up to point of exceeding 700,000 in the last years of growth up to 2007, while the price of unsubsidised housing grew 193% between 1998 and 2008, multiplied by three in a period of only ten years.

This growth model, which characterized the Spanish economy for more than a decade, based on the construction of housing at a rate far superior to the real demand, was not sustainable in the long term. And as soon as residential construction returns to normal and

evens out on sustainable levels, estimated at around 350,000 dwellings per year, the enormous excess capacity in the sector will become evident, an excess which necessarily leads and will lead to a strong adjustment in the levels of activity and employment. And this is already the current situation.

Thus, since the middle of 2007, property investment has dropped 35% in real terms, to such an extent that it now accounts for 24% of total investment and, in the economy overall, no less than one million six hundred thousand jobs have been destroyed, of which close to one million originate from the construction sector. And a large part of these jobs, also around one million, will have disappeared forever, as the sector must readjust its size to the sustainable demand, to bring it into line with those of the other developed economies.

Another figure illustrating the magnitude of the adjustment affecting the property industry is the collapse of the sale of housing units, which has fallen to less than half, from a monthly average of approximately 80,000 at the beginning of 2007, at the height of the cycle, down to around 35,000 at the present time, including the purchases of second hand homes, while the number of housing starts in 2009 will have reached around 200,000, in comparison to 700,000 in the years of greatest activity, below even the average of 250,000 housing starts per year before the bubble began to inflate.

The fact that during the expansionary stage many more dwellings were built than required by the sustainable demand in our country gave rise to the generation of an enormous stock of unsold housing.

Looking at the economy of our country from the start of the expansionary stage, we can say that we have been living beyond our means for a long time, consuming and investing more than what we were producing, and financing that standard of living by means of increasing indebtedness, both in the case of families as well as businesses, thanks to the low interest rates and a practically limitless availability of liquidity. Consumption and investment thus exceeded our Gross Domestic Product, a situation which, at the end of the expansionary phase, determined a foreign trade deficit of close to 10% of that Gross Domestic Product, a deficit which, in percentage terms, ranks among the highest in the world. As a consequence of all of this, the debt of families has risen considerably, up to 85% of GDP, while in the case of businesses the debt figure soars to 135%, according to

Bank of Spain statistics; in both cases, this is almost triple the level existing in the mid nineties. This level of indebtedness is unsustainable and is the reason why Spanish households and businesses cannot continue to invest or to consume at the same rate. They must get their finances in order and reduce their indebtedness, all of which leads to a sharp cutback in the level of consumption and of investment.

It is in these two major imbalances generated during the expansionary phase –the high indebtedness of households and businesses and the excess capacity in housing construction– where the origin of the acute economic crisis we are suffering today lies. The immediate effect is the enormous increase in unemployment which, in addition to constituting a social drama, signifies an important burden for future recovery, as the social welfare benefits, logical in order to alleviate the situation of the families affected, pose an additional demand on public resources.

In regard to Spain's financial institutions, these entities resisted the initial onslaughts of the financial crisis with remarkable strength within the major world banking sector. The more stringent traditional regulation by the Bank of Spain, together with a more orthodox conception of the banking business, reduced the exposure of Spanish banks and savings banks to toxic financial assets, whereby they were initially affected to a much lesser degree by the international financial crisis.

However, the exposure of Spain's financial institutions to our property bubble was considerable at the end of the expansionary stage. Loans to households for the purchase of homes, together with loans to builders and developers, accounted for 61.4% of the total loans granted in the last quarter of 2007, according to figures published by the Bank of Spain; and the exposure of the savings banks was even higher, with a figure of 70.6% with respect to all of the loans granted.

As a consequence of this high involvement, as our economic crisis advanced, with rising unemployment and a property sector in freefall, the quality of the assets in the hands of our financial institutions deteriorated and the level of default increased. And so in Spain, we then faced our own problem of other toxic assets, that is, those linked to our property bubble.

The origin of our financial crisis is, therefore, internal as well, linked to the collapse of the property business. And, in addition, the international financial crisis, particularly well into 2009, contributed decidedly to deteriorating the situation of the Spanish financial sector, on making it more difficult to obtain access to financing from abroad, a source of financing on which our banks and savings banks had been depending during the years of economic expansion.

3. Current situation of the world and the Spanish economies

What is the situation of the world and the Spanish economies today?

The world economy overall began to improve starting in the second quarter of 2009. In contrast to the other major crisis, which broke out in 1929 and gave rise to the Great Depression of the thirties, on this occasion the measures adopted by Governments and Central Banks throughout the world prevented the history of those years from repeating itself. After the collapse of economic activity and world trade occurring in the second half of 2008 and in the first half of 2009, the height of the financial crisis worldwide, the conditions of the international financial markets stabilised considerably, thanks to the extraordinary measures adopted by the Central Banks on making massive injections of liquidity in order to alleviate the shortfalls of financial institutions. And thanks also to the assets buy-out measures set in motion by Governments to assist many of these institutions.

In addition to the improvement of conditions in the financial sector, the global economy began to offer facts and figures of recovery in the second half of 2009, to the point where, for example, Germany, Japan and France began to present positive growth rates in the second quarter of 2009, and the United States and Italy in the third. Many doubts still remain as to the consistency of this recovery, due to the fact that significant difficulties still persist in the financial sector and due also to the possible excessive dependence of the recovery on the stimulus measures put into place by Governments. And this is the reason why we are looking at a fiscal year, that is, 2010, with hopeful figures but also with significant uncertainties.

In any case, in Spain, economic recovery is moving more slowly. In the second half of 2009, the decline of economic activity and of employment was reduced considerably, largely as a consequence -the same as in the rest of the developed countries- of the stimulus policies. However, the figures still do not allow us to speak of the start of a new phase of growth in our country.

Today in Spain, with respect to the private sector, we are in the process of remedying these imbalances; however, three major difficulties are slowing down their recovery:

- On the one hand, the property sector is going to continue to hamper growth, since, until such time as the stock of unsold housing is substantially absorbed, the residential sub-construction sector will not be able to recover a stable level of activity, not even on a lower level than during the expansionary phase.
- On the other hand, although households have made a significant effort to put their finances in order, have increased their savings rate and have begun to reduce their level of indebtedness, such level continues to be very high, which, combined with the persistence of very high unemployment rates as well, is going to limit the growth potential of consumption for quite some time.
- Thirdly, the normalisation of the potential for increased consumption is also going to lag on account of the lack of credit, which is not going to return to completely normal flows until the financial sector is able to recompose its balance sheets and eliminate the toxic property assets.

With respect to the public sector, the crisis is giving rise to a serious and very disturbing problem of the national debt. From a surplus of between 1% and 2% of GDP between 2005 and 2007, in 2008 there was a deficit on the order of 4%, and in 2009, it is estimated that the deficit may have increased up to 10% of GDP.

A part of this deficit is due to discretionary decisions, in the framework of the Government's fiscal policy, aimed at stimulating the economy. However, another significant part is structural, that is, this is a deficit which is not going to right itself alone when the economy begins to grow again or when the discretionary fiscal policy measures are withdrawn, as it reflects a structural imbalance between public revenues and expenditure.

During the stage of economic growth, this structural deficit remained camouflaged by the extraordinary revenues originating, directly or indirectly, from the property bubble; that is, temporary revenues, just as unsustainable as the very growth model on which they were supported, but which were used to finance a continuing increment in public spending. However, when that growth model tumbled down, those extraordinary resources followed suit and left a significant structural deficit exposed.

As a consequence of the explosion of the deficit, the level of public debt, which represented 36% of GDP in 2007, appears to have increased up to 55% of GDP in 2009 and is estimated to rise to more than 75% in 2011. Our initial level of public debt was one of the lowest among the developed countries, a circumstance which has given our economic policy room to manoeuvre when funding urgent measures against the crisis. However, this room to manoeuvre is shrinking, considering that in the rest of the advanced countries, public debt is also rising rapidly and that we will have to compete with this in the future, a fact that will raise interest rates, displace productive investment and considerably increase the relative weight of the payment of interest in national budgets.

During the next few years, the need to balance the public finances, which must reduce their imbalance to a maximum of 3% in 2013, is going to impose a restrictive slant on the public consumption expenditure policy, which is going to mean an added difficulty for GDP growth. And, of course, with weakened private consumption and with a desirable reduction of non-productive public expenditure, the Spanish economy will have to increase its exports, if it wants to maintain a level of aggregate demand enabling some degree of growth.

4. The way out of the crisis. Immediate measures

After the foregoing considerations on the current situation of our economy, certainly a difficult one, I now wish to present a few reflections on possible measures for emerging from the crisis.

I will refer first to those which I consider to be immediate short-term measures. And, then, I will go on to consider the adjustments necessary, the effect of which will only be felt in the medium and long term, but which are indispensable, in my personal opinion, if our country wants to recover its competitiveness and maintain a prominent place in the world economic framework, once the crisis is over.

4.1. Action plan for infrastructures

And let us begin with the immediate measures, which I believe must impact directly on the construction sector, due to the strong pull this sector exerts on the rest of the economy. An action plan of public investment would give new impetus to employment, avoiding entering into a spiral in which social welfare expenditure linked to unemployment together with low tax revenues would increase public debt and paralyse economic growth during a longer period of time.

We are all aware of the difficulties of combining an increase in public investment expenditure with a reduction of the deficit; a reduction which we are obliged to achieve on account of our commitments to the European Union. I will try to offer a few ideas.

In a new scenario of economic recovery and growth, infrastructures play a central role. The effort of investment in infrastructures made in previous years needs to be maintained and intensified during 2010 and subsequent fiscal years.

In this context, the work being carried out by the Ministry of Development, whose intention is to maintain the high level of public tendering of the past legislature, is fundamental. In the last seven years, investment in transport infrastructures has reached the figure of 100,000 million euros, with an average of 14,000 million per year. And, against the background of that average annual figure of 14,000 million, it is important to note that in 2009 the Ministry of Development invested close to 20,000 million euros, and that for 2010, the Draft Budget for this Ministry plans for a similar investment, in excess of 19,000 million.

Nothing has contributed as much to the progress of Spain and to its territorial cohesion as has the improvement of its infrastructures, always a determining factor for the economic development of a country, by facilitating access to markets, reducing transport costs, giving impetus to the exchange of goods and services and increasing productivity.

The action plan necessary to enable Spain to get back on the path of growth must take a firm stand in favour of intermodal transport, that is, the optimum integration of the different modes of transport which, in each instance, will guarantee the most efficient integrated system.

Expanding the use of railways for the carriage of goods is fundamental. Without a doubt we are looking at an important issue as yet to be resolved. In recent years, the carriage of goods in our country has registered growth at a rate of more than 7% annually, and yet, rail transport, which emits five times less CO₂ than road transport and is economically much more efficient, has not benefitted from this increase. This situation calls for a change of course. And I feel that the fact that the Ministry of Development is working on the start-up of a Stimulus Plan for the Carriage of Goods by Rail is a move in the right direction.

In the area of the conveyance of passengers by rail, I believe that the process of liberalisation and opening-up of the sector to private initiative, which is now at a standstill, should be accelerated, ensuring competition with the public sector on equal terms.

Moreover, the necessary urgent measures of major investment in infrastructures must assign a fundamental role to the private management of the concessions for those infrastructures, because such private management contributes added efficiency in the management of the projects awarded under concession and optimises the timeframes and resources used.

In order to maintain the investment effort which our economy needs without increasing public debt, the availability of public funds must necessarily be supplemented by private resources through public-private mechanisms of cooperation.

A true reflection of this firm wager on the cooperation between the public sector and private initiative is the Extraordinary Infrastructure Investment Plan, designed by the Ministry of Development, with an ambitious budget of 15,000 million euros. The Plan is to be financed

to the extent of 50% by the European Investment Bank, 20% by the ICO (Institute of Official Credit) and the remaining 30% equally by construction firms and banks. Without a doubt this Plan would serve to reactivate the construction sector and, by extension, the Spanish economy. In this context, the construction sector will be once again a fundamental element in the recovery of Spain's economy in the current crisis and in its subsequent growth.

I would like to recall here that the European Commission has recently expressed the importance it attaches to the mechanisms of cooperation between the public and private sectors in the financing and operation of infrastructures, through the presentation of a document with which it seeks to encourage the use of such mechanisms, which is still limited, in the Commission's opinion.

Among the arguments in favour of public-private cooperation, the European Commission mentions

- improvement in the performance of projects,
- the obtaining of greater economic returns from the infrastructures,
- the distribution of the cost of the financing of the infrastructures throughout their useful life
- and a balance in the distribution of risk among the public and private participants.

In addition to the European Commission, the European Investment Bank is also very active in its support of effective formulas of public-private partnerships throughout Europe, particularly in transport infrastructures.

In the face of this new stage, in the financing of public-private partnership projects, it is essential to address a qualitative change with respect to previous stages, given the current situation of the scarcity of credit and the tightening of credit conditions. And in this context, as a complement and alternative to bank loans, greater attention must be given to methods already used earlier within the Spanish sphere, such as the placement of securities and bonds in the long-term debt financial markets.

France and Great Britain have already addressed the establishment of a regulatory framework in which the State provides the guarantees of solvency necessary in order to have recourse to the financial markets, replacing instruments which previously performed

this function, such as the monoline insurers which, at the present time, are unable to provide this service due to the deterioration of their ratings.

Also in Spain, the Council of Ministers has already approved the sending to Parliament of the *Draft Law for Capturing Sources of Financing in the Markets by Public Works Concessionaires*, the principal objective of which is to establish a regulatory framework that will facilitate the channelling of private resources towards the construction of infrastructures through public works concession agreements; and to this end, the proposed legislation introduces measures designed to improve and expand the guarantees which the Administration can provide to those who obtain concessions or public contracts.

The Spanish Administration, the same as the Administrations of other European countries, is willing to take up the role which the monoline insurers formerly played, by providing a guarantee to investment projects selected by the Administration itself. By means of this guarantee, the promoters of the projects will be able to approach the financial markets in order to obtain financing by means of issuing bonds and securities, thereby complementing the bank financing, which is going to be scarce in the immediate future due to the financial crisis. This mechanism is not going to affect the public deficit, as the returns from the projects financed will prevent such guarantees from becoming effective.

In order to round off this outstanding support by the Administration, and to encourage the participation of private financing in the construction of infrastructures, it would be advisable to take another step forward from a tax point of view, by introducing tax rebates of 95% for the returns from the long-term debt financial instruments, an aspect which has already been considered in the United States and which has precedents in Spain, with a rebate of 95% of the interest from the bond issues which financed the first toll roads in our country.

For a more effective operation of public-private partnerships, there is a need to revise the range of tax regimes affecting them, where the possibilities of the system have deteriorated over time, by taxing both the investment as well as the returns derived from this public service, with tax requirements which certainly exceed those applied under other legislations both within Europe as well as in other parts of the world.

4.2. Adjustment of the property sector

In regard to the adjustment of the property sector, I believe that in any case the measures designed to favour the artificial support of residential construction must be rejected.

Fresh plans for building subsidised housing should eventually consider the existence of the stock of unsubsidised housing, as until such stock is finally absorbed, it is going to drag down the economy and employment.

Property developers can contribute to accelerating the process of the adjustment of the sector, by clearing out the stock of surplus housing units as soon as possible, selling them at realistic prices. Another possibility for eliminating this stock is the rental market, which is affected by a chronic problem of insufficient supply, constituting one of the main reasons preventing the emancipation of our young people and hampering the geographical mobility of our workforce. The current situation of the property market can be considered as a real opportunity for creating a genuine housing rental market in Spain.

4.3. Financing of SMEs

Other immediate measures for confronting the current adverse economic situation are those associated with the financing of SMEs. The difficulty in accessing credit experienced by these businesses contributes to intensifying the seriousness of the crisis, by converting temporary problems of liquidity into problems of definitive insolvency. Feasible businesses are closing their doors due to the elimination of the lines of credit with which they routinely financed their cash imbalances, also generating a domino effect which spreads the decline of activity and the loss of jobs.

The financial institutions must culminate the process currently underway for the recapitalisation and clean-up of their balance sheets. And in order to do so, there is an imperative need to set in motion effective measures for providing liquidity to SMEs. The measures put into place by the Government at the end of 2008 and beginning of 2009 through the ICO (Institute of Official Credit) in order to achieve this purpose have not been successful. And it is probably necessary to assign this institution new tasks, as recently announced by the Government, to ensure that the lines of liquidity reach entrepreneurs and to thereby prevent the disappearance of the truly viable small and medium enterprises.

And the speeding-up by the Public Administrations of the payment of the debt owed to these businesses would also have an immediate effect.

5. Long-term adjustment measures. The necessary improvement of the competitiveness of Spain's industry

We have considered three short-term measures in order to initiate a way out of the crisis: an urgent action plan for investment in infrastructures, the reduction of the unsold housing stock and the financing of small and medium enterprises. And now we are going on to consider the necessary long-term adjustment measures.

We must base our economy on a more solid and sustainable foundation in the long term by means of achieving a competitive, export-oriented industry.

In this regard, the loss of competitiveness suffered by the Spanish economy during the years of strong economic expansion is a reason for serious concern and is reflected in our insufficient export capability. In effect, our market share of world exports has come to a standstill at 1.8%, far below the weight of the Spanish economy in the world economy overall, which is 2.6%. Moreover, the percentage of GDP which our exports represent is only 26%, in comparison to the 41% average in the European Union. All of this indicates that Spain exports one-third less than what it should in relation to the size of its economy.

The enormous loss of competitiveness experienced by our economy in the last few years is reflected in the competitiveness classifications which are made on a regular basis by a number of international bodies and institutions, such as the World Bank, the World Economic Forum or the *Wall Street Journal*. And this serious loss of competitiveness stems from two key indicators:

- In the first place, the persistent inflation differential which, from the monetary integration in the euro in 1999 and up to the start of the crisis, had been placed on an average of one percentage point each year. And thus, from the start of the Monetary Union and up to 2008, prices rose in Spain 12% more than in the rest of the countries in the eurozone; that is, in a matter of only nine years, we have become 12% more expensive.
- The second indicator impacting on our loss of competitiveness is the higher growth of the labour costs per unit produced in real terms. Since integration in the eurozone in 1999 and up to 2008, these costs have risen almost 33% in Spain, in comparison to rises of 15% in the European Union overall and of only 2.5% in the case of Germany. And we need to pursue a sustainable growth in wages in order to

move ahead on the path of competitiveness, necessary in order to position our economy in its proper place in the international sphere.

Another contributing factor to the increase in labour costs per unit was the poor progress achieved in productivity, which during the same period grew only 2.1% in our country, in comparison to 8% in the EU overall, 8.6% in Germany or 13.6% in the United States. It was only in the last two years, 2008 and 2009, that Spanish productivity grew more than in the EU, but not as a consequence of a genuine increase in production efficiency, but rather as the result of an effect derived from the extraordinary harshness of the adjustment of employment in our country.

Our industry continues to be specialised in mature sectors with an average-to-low technological content, in which the key competitive factor is the price, in contrast to the technologically more advanced sectors where the competitive factor is the uniqueness of the product. This is the reason why in our country, production cost performance is the determining element of our export capability.

The major challenge facing our economy when looking towards the future is to make our production system increasingly more competitive. In order to do so, we must give impetus to the development of technologically advanced sectors, where competition is not based solely on the price and which contribute more added value and, therefore, higher returns and wealth.

And, in the very first place and as a long-term commitment, this requires a significant and sustained stimulus to R&D&I tasks.

5.1. Stimulus to R&D&I and the new technologies

The difficulty of our production system in order to advance towards an industry, with greater added value and more competitive internationally, is explained basically by the scant implementation of the new technologies and of innovation in production processes, in comparison to other advanced countries, all due to the low level of investment in R&D&I.

This investment represented 1.35% in Spain with respect to the GDP in 2008, still below the average of close to 2% in the European Union. There are other indicators reflecting the scant technological capacity of our production system, such as the low relative weight of

our stock of technological capital which, in relation to the GDP, is only 5.8%, in comparison to 10.7% for the eurozone overall, or our poor market share of world high technology exports, with scarcely 0.5%.

A degree of progress has been made in all of these indicators over the last decade; however, it is a slow advance. We must take into account the fact that there is no tradition of activities of this kind in Spain and that we became a part of this industry much later than other countries.

This is why our economic policy should maintain an ongoing and increasingly greater effort to give impetus to the introduction of the new technologies throughout the production system and in order to further actions in the field of R&D&I.

5.2. Support to the internationalisation of Spanish companies

On reviewing the ongoing measures for enhancing the competitiveness of Spanish companies, a need is identified for their internationalisation, since direct, continuing contact with foreign markets and participation in the current of globalisation of production constitute a key source of entrepreneurial effectiveness.

One of the principal engines of growth on which the Spanish economy should focus is internationalisation, the penetration of foreign markets by Spain's entrepreneurial fabric, as a channel to reduce the excessive trade deficit of our country.

Reference has already been made to the scant percentage of GDP represented by our exports and to their low market share of world trade, facts which reflect a lack of competitiveness but also little interest on the part of our companies in exporting. Our economy shows a deficit in practically all of the foreign trade headings, except for food, ceramic products, transport equipment, automobiles and footwear.

Considerable progress has been made over recent years with respect to internationalisation through investments abroad and the establishment of Spanish companies in other countries. Spanish investment abroad has been multiplied by 35 since the early nineties and up to 2008, and has gone from accounting for 0.6% of GDP in the period between 1990-1995, to representing 6.3% of GDP in the period between 2000-2008. Since 1997,

each year –except for 2002, direct Spanish investment abroad has surpassed the figure of the direct foreign investment in Spain. That is, our country has been a net investor abroad.

The sustainability of the process of internationalisation of Spanish companies and, consequently, of our economy calls for an increased presence in new markets in order to export more, with more technology and with a greater international vocation on the part of our companies.

As an example, I am taking the liberty of noting that for the Villar Mir Group, which I have the honour to head, internationalisation is a key element of its strategy and one of its fundamental management principles.

Thanks to this determined effort, today we are a Group with a permanent productive presence in 27 countries, with a clear majority of our 28,000 employees, of our investments and of our generation of funds and profits located abroad.

5.3. Structural reforms

Among the measures necessary for improving the competitiveness of Spain's industry, after referring to the R&D&I activities and to the support of the internationalisation of Spanish companies, we must also mention the need for reforms, of real, far-reaching structural reforms, in order to establish a framework of action that will enable the evolution of our companies towards a more competitive model.

I can think of at least six major structural reforms as absolutely necessary. These reforms refer to the following:

- Education
- Tax
- Labour Market
- The Public Administration
- Energy Policy and
- Market Unity

Fortunately, there is a recent, broad consensus with respect to the need of a reform of the educational system, in the sense of requiring greater dedication and effort in order to develop a spirit of personal achievement and excellence.

In the last few weeks, three very important positive developments have occurred with respect to the necessary Education Reform:

- The decision by the Minister for Education to approach this Reform as a “policy of State”, that is, a permanent reform with sufficient consensus enabling it to remain in place despite changes in the ruling party.
- The agreement of the Partido Popular to participate in the definition and adoption of this Reform.
- And the approval by the Community of Madrid of a Draft Law guaranteeing the authority of teachers.

Three positive developments enabling us to expect that the necessary Education Reform will be achieved quickly as a true “policy of State”.

The remaining Reforms are just as necessary.

Up to now, frequent allusions and references have been made to Tax Reform and to Labour Market Reform. And, fortunately, recent statements made by the Government suggest an open attitude towards undertaking studies and actions in both directions.

And we should hope that this same disposition towards undertaking studies and actions will extend to the other three Structural Reforms mentioned, the Public Administration, Energy Policy and Market Unity.

6. Reasons for confidence

I am going to conclude here and will do so by arguing that there are many reasons why we should all be truly confident -as I certainly am- that there is a way out of the current crisis.

We have acknowledged, and it is unfortunately true, that Spain's economy is going through one of the worst crises of its history. And it is also true that the dramatic decline in activity and employment experienced at the end of 2008 and the first half of 2009 has become less intense in the last part of 2009, although we have not yet entered into a situation of clear recovery.

In 2010 the situation will continue to be very difficult, with a slightly negative or positive GDP growth rate, but probably less than one percent. And it does not appear that we can expect a recovery of employment until 2011.

Where does this confidence come from?

I would like to express, and I do express, my full confidence that Spain will be able to meet the challenge confronting it and recover its proper place among the most developed countries.

My personal confidence in the near future is complete and thus, in the Group which I founded 22 years ago and which I head, we have continued to invest figures on the order of one thousand million euros per year in infrastructures with private financing in Latin America and in Spain. And from the industrial divisions of the Group we are launching three major investments, worth a total of more than another 2,000 million euros, distributed among China, Algeria and Spain.

Our confidence rests on two fundamental facts:

The first fundamental fact refers to the most transcendental event in the history of the second half of the twentieth century, the fall of the Berlin Wall in 1989, which exposed the myth of communism as an effective solution for the development of peoples.

Thanks to that historic event, the world economy followed the course of an intense process of globalisation, which is making possible one of the stages of greatest economic growth and progress of our entire history, with an even greater expansion of world trade. And this has been achieved in a context in which the two major concepts, which have driven the world in all latitudes, are democracy in the political sphere and the market in the economic sphere.

The world had been divided for seventy years into two antagonistic blocs and, in the wake of the disappearance of the myth of communism as a generator of wellbeing, all countries, with extremely few exceptions, began to work in a market system.

The expansion of the free world with the incorporation of the former communist bloc countries into the market economy drove the world economy towards globalisation, with the full deployment of all of the potentialities which the free market economic system is capable of providing, insofar as the capacity for progress and the improvement of the wellbeing of mankind.

All of this takes us to a growing interdependence among nations, in which some economies drag others with them in their wake, whereby both recessions as well as expansions spread quickly around the world. And, in this way, an economy, such as the Spanish economy, which has suffered the effects of the crisis more severely, will in turn benefit from the “pull” of the emerging economies, such as China, India or Brazil, transformed into new locomotors of the world economy; and it will also benefit from the positive knock-on effects of the other European economies.

The second fundamental fact is that Spain has a new strength in this crisis which consists of the international dimension, the financial capacity and sector-level leadership of some of its major business groups in a range of sectors; including banking, infrastructures, construction, telecommunications, renewable energies and the fashion industry, without overlooking our traditional position as a leader in leisure time, tourism and gastronomy. All of this has been backed by the outstanding world prestige of our principal business schools and by the high level and capacity of our best executives.

Supported on these two fundamental facts -both new, as they did not exist twenty years ago, our economy is endowed with the strength necessary in order to confront this and future crises. However, this will not be possible without the effort and commitment of all of Spanish society and without the involvement of all players -business and workers and political parties- in a major pact, without excluding any form of political agreement. We all need to lend a hand, by working more and better, with a constant spirit of overcoming the odds, with each and every one of us putting forth the effort necessary in order to help ourselves and to help our country in these difficult times.

As so often occurs in history, things have to take a bad turn in order for the players to react.

The difficult situation which we are experiencing now should spark a reaction so that Spanish society overall will become aware of the need to act and to undertake the long-term reforms necessary, some of which are difficult, in order to place our economy on a pathway of modernity, growth and creation of employment.

The measures taken by the Government up to now have been basically for the short term, however, the political discourse has already begun to refer to long-term reforms needed by our economy.

In the first years of the transition, in which this Club Siglo XXI certainly played a decisive role, the spirit of cooperation and the climate of understanding and mutual trust impregnated the relationships among the political parties and also between management and unions, and constituted one of the major assets in the most difficult times of our recent history; times, I say once again, much more difficult than those we now face. At that time, the necessary effort of generosity of all players did materialise. And today, we are being called upon to make an effort to recover that spirit, now more necessary than ever, as the consensus of all of the political and social forces is required in order to set in motion a genuine "policy of State" and to undertake the reforms needed for modernising and consolidating an economy which has stopped being competitive.

All together, all working towards a common goal, all of us placing the interest of Spanish citizens above any other kinds of concerns, of political parties or of social classes.

We are facing an important challenge. And we will succeed in overcoming it. Thanks to the support of Spanish society overall, committed to the future of its country.

All of us, as in the popular saying, "God helps those who help themselves".

I thank all of you very much for your attention.