

The current and previous crises

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The current crisis is only comparable in intensity to those of 1929 and 1973, apart from others originating from wars or catastrophes. The collapse of stock exchanges is a general feature of any crisis, out of simple logic. They also have all in common that they are the result of errors done in economic policy, though different in every case. Economic crisis is, in a way or another, linked to financial crisis. The 1929 crisis was deflationary, the 1973 one inflationary, and there are doubts about what the current one is. In the present case, the efficacy of collaboration between governments and international economic institutions will be put to the proof for the first time. Recovering confidence is a previous step to solve problems.



Economic cycles

Economic cycles are a reality, although some economists had considered them overcome a few years ago in the light of bullish markets. The Catalan, Spanish, European and global economy has followed a path of growth in the last two centuries, albeit irregular, like sawteeth. After a period of expansion comes one of recession, usually the consequence of errors or excess done in times of exaggerated optimism. The bigger the errors or excess, the deeper a crisis. However, in developed economies – of which Catalonia is one – the starting point of a new growth period is usually above that of the previous economic cycle. The world is making overall progress in spite of crises.

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Sawteeth, i.e. economic crises can be more or less deep, more or less generalised or restricted to a given geographical area, they may affect the whole of the population or only some specific sectors, they may be short-lived or last long. The economic crisis started in 2008 is deep and generalised. If we intend to compare it to any previous crisis having the same properties, we need to go back to 1973 and 1929. However, we must bear in mind that the 20th century, in which these crises occurred, was unfortunately characterised by the two big World Wars and a whole set of geographically restricted wars, each of which triggered a deep economic crisis, especially among the vanquished. Nevertheless, the object of this article is to deal with economic crises caused by other reasons than military conflict, as a result of ordinary human activity without the use of weapons.

All economic crises show similarities in certain points and differences in others. They all cause recession – a temporary decline in GDP – or

depression – deeper recession – but differ in time to recover normal parameters, the political and social framework they develop in, the geographical area affected as well as measures taken – or not – by governments and economic institutions.

All recessions in the last centuries have been related to a bearish stock exchange, the capital market and most representative symbol of investor confidence or distrust.

The 1929 crisis

In **October 1929**, Wall Street crashed. Stock prices had been on an unstoppable rise since 1926, reaching levels that bore no relation with the balance sheets of listed companies. Many people had started investing in stock as a way of making easy money, without having any knowledge. It was not investment but speculation with stock offering gains within days or weeks. In this respect, there is a coincidence with the years prior to the current crisis.

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The American stock exchange went down in an uninterrupted way, till it reached its bottom in late 1932. By then, quotations were down a rough 80% related to October 1929 prices. In the meanwhile the carpet of corporate accounting truth had been lifted, showing that balance sheets were clearly on the down. To put it simple, the October 1929 crash was a consequence of stock investment excess, emphasised by a latent economic crisis. Also here we may find a point of coincidence with the current crisis. The American stock exchange started to recover in 1933, a development that was crushed in 1937 by another decline in quotations, which kept up to the outbreak of World War II.

The American stock exchange crisis unleashed a financial one. Much of speculative stock investment had been done on credit, so delinquency affected banks and their liquidity. American banks claimed back their deposits from European banks, and the crisis spread over to Europe. In 1930, more than a hundred small and medium-sized American banks went bankrupt. The first European bank to close was Vienna-based Creditanstalt in May 1931, followed by many German banks.

The 1929 crisis was deflationary, with a general price decline and implementation of protectionist policies by governments, which led to considerable world trade contraction and misery. This misery is masterly described in the first films by Charlie Chaplin. To find a way out of the crisis, many political meetings and international conferences were held, but lack of cohesion among the main powers was absolute. There was no international cooperation. This only worked for the first time in history after World War II with the Marshall Plan.

In Europe, the misery of the German people, aggravated by reparations for World War I imposed by the winners, led to the rise to power of Nazism by democratic means (1933). In Italy, the fascist regime had seized power in 1922, though not so democratically. The United States government, as Hitler and Mussolini did, went for interventionist policy advocating public expenditure to surmount the crisis: this was the «New Deal». In 1933, Mussolini's Italy created the Istituto di Ricostruzione Industriale (Institute of Industrial Reconstruction, IRI), which was the model by which Francoist Spain created the Instituto Nacional de Industria (National Institute of Industry, INI) in 1941.

Global economic crisis reached Catalonia in a moment of change of political regime. The Second Republic – proclaimed in May 1931 – was enthusiastically accepted by most of the population, but the difficult economic setting did not facilitate its consolidation. In July 1931, the Banc de Catalunya suspended payments and the Barcelona City Council stopped paying

out its debt coupon. Two examples of financial crisis: «The fall of the Banc de Catalunya – a mixed, commercial and industrial bank – is the reflection in Spain – and more specifically in its most industrialised regions – of one of the most distressful times in modern capitalism.»¹ It is in the most developed areas like Catalonia where the impact of the crisis was most felt; in Andalusia, misery was permanent anyway.

The moderate policy implemented by the different Spanish Republican governments and the restoration of the Government of Catalonia (the Generalitat) did not satisfy neither the working class, radicalised by very powerful anarchist movements, nor the bourgeoisie, which saw that the economic situation had cut their benefits. The outcome was the Civil War and a long dictatorship that did not show any sign of economic rationality at least before 1959.

The 1973 crisis

There are considerable differences in setting the beginning and the end of this long-running international crisis. To some, it started with the oil price surge starting in 1973. Between late January 1973 and January 1974, it multiplied by 5.7. But also here, deep underlying economic problems were stated, so the oil price did nothing else than trigger this situation.

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It took a long time before Spain became aware of this global crisis. In December 1973, prime minister Luis Carrero Blanco was assassinated, and economic concerns became secondary. Politics were given priority: the country was turning to terrorism in the Basque Country, the dictator's health, his foreseeable death and

the unforeseeable political future. Spain was the only European country where petrol consumption went on increasing in 1974 and no retainment measures were taken. General Franco died in November 1975, and a complex political transition started. It was not a good moment to take economic decisions, which the rest of European countries had already taken, allowing them to see the light in the end of the tunnel much earlier than Spain. Here, the first measures were taken only in 1977, with Enrique Fuentes Quintana as deputy prime minister in charge of economic affairs in a government led by Adolfo Suárez: devaluation of the peseta by 20%, a first tax reform and monetary and fiscal measures.

By signing the so-called Moncloa pact, the new political parties and trade unions accepted a truce in their political struggle until the crisis would be under control. Reducing inflation from 24.5% to 22% in 1978 and curbing credit growth were immediate goals to achieve. As opposed to what happened in 1929, the 1973 crisis was clearly inflationary, but like the former, it occurred within a framework of strong social unrest in Spain and a serious industrial crisis in Catalonia.

The banking crisis began in 1978 with the Banco de Navarra – one in many cases of speculative business that was all but rational – and ended in 1993 with the collapse of the Banco Español de Crédito. A total 62 banks suffered officially from its consequences, which would have been worse if the Bank of Spain had applied equal rules and criteria to all. The result was a hardly spontaneous concentration of banks on the negative side and reinforced measures to control solvency of banks and savings banks on the positive.

The 1973 crisis, which became apparent in Spain only two or three years later, took longer to wear off here than in the rest of developed countries. Its end was only felt in 1984 – an endless crisis, aggravated by political transition to democracy, but fortunately with a happy end: a parliamentary monarchy.

Two relatively minor crises

Between the 1973 and 2008 crises there was a recession in 1992-93 and a speculation bubble in 2000. It is worth having a look at them as an example of the reality of economic cycles and sectorial bubbles.

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1992 was the year of the Barcelona Olympics, a great event in the city and Catalonia. This often pushes back the fact that the economic situation was not very bright then. Germany had stopped being the engine of Europe as it was trying to solve its problems created by reunification with the eastern part of the country, and all Europe suffered from it. In Spain, that year ended with GDP growth at 1.1% but inflation at 5.4% and unemployment at 20%. The Minister of Economy, Carlos Solchaga, was implementing a policy to defend the peseta through very high interest rates: credit was at an 18% plus commissions. The situation became unbearable, and between September and November 1992, the Spanish government was forced to devalue the peseta twice: 5% and 6%, respectively.

1993 set an end to minister Solchaga's economic policy, with a third devaluation by 8%, marking the end of a period defined by the *Financial Times* as «*machismo*» (*sic*) in the system of setting the peseta exchange rate. For the first time, Spain was officially in a recession, with GDP declining by 1%. Pedro Solbes replaced then Carlos Solchaga as Minister of Economy.

1994 saw a recovery of the Catalan and Spanish economy led by the industry. The sounder US economy, which spread over to Europe, also had its influence. However, unemployment was stable at 23.9%, while inflation was at 4.3%. It was the year of financial scandals,

with Mariano Rubio, former Bank of Spain governor, and businessman Javier de la Rosa in the headlines. But the peseta was still overvalued, and another 7% devaluation took place in 1995. In the end, the Spanish currency had lost 35% of its value against the Deutsche mark.

The 20th century ended with growth deceleration in the world economy and the burst of the speculative bubble related to internet companies, those called the «new economy». The clearest example is Terra, a Telefónica subsidiary based in Barcelona. Terra Networks was established in 1998. In late 1999, its shares were quoted at 11 euros. Then it merged with Lycos, one of the main US internet portals, creating the third largest internet group of the world, only behind America Online and Yahoo! On 14 March 2000, the Terra Lycos shares were quoted at 157.65 euros. That day marked the start of their decline, which was as sudden as had been their rise, eventually leaving the share price under the initial 11 euros by the end of the year, and with company losses higher than that year's turnover. All internet companies went the same way. The Spanish Ibex-35 stock exchange index lost 21.75%, dragged down by «new economy» stock. Going too fast is obviously very dangerous.

The 2008 crisis

A real estate crisis in the United States – involving **subprime** loans – Spain and some other European countries was already visible in 2007, but nobody saw the financial and confidence crisis that became apparent in mid 2008, nor that the US, British and other European governments would agree on intervening unmistakably in some big financial institutions, against some enthusiastically preached governmental principles of economic liberalism. Once again it was stated, upon lifting the carpet of real economy, that apart from real estate sins acting as a trigger, there were some others – especially financial ones – originating in the United States but affecting the world economy. These financial sins included just about

anything, from fraud to outrageous financial products. If the 1929 stock and financial crash in Wall Street took some years to reach Europe, this time it got there within hours.

The current crisis came after a long period of euphoria with low interest rates causing strong leveraging of individuals and companies, especially in our country. Meanwhile, the stock exchange was growing, following a clearly parallel evolution to 1929. The crisis became visible when the real estate bubble burst. But American subprime loans had nothing to do with the real estate and building crisis, which affected heavily Catalonia but much more other Spanish areas such as Madrid, the Costa del Sol and Valencia. What we find here is excessive housing building funded with credits that cannot be repaid upon maturity as sales have dropped dramatically. The crisis affects big companies and pushes the financial crisis.

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Financial organisations operating in Spain had catered for disproportionate credit demand with resources from the European interbank market, especially Germany, which had a surplus. This is another distinctive feature of this crisis, though not in its result. Those countries with a surplus also had a market to serve and internal problems. The reduction of this offer will thus force Spanish banks to reduce their credit offer. Credit, which had increased at an annual 20% rate, is now reduced to 7%, with severe consequences for those wishing to renew their credit lines or fund new projects. In fact, no recovery can take place without restoring a normal credit flow.

Finally, there is a crisis of trust that can jeopardise the end of the economic crisis. A considerable, yet minority part of the population is directly affected by the situation: the building and

building material branch as well as stock investors caught by American bankruptcies. The rest of the population, whose income has not shrunk, has an influence on the economic situation as it is cutting on consumption and shifting its priorities regarding expenditure. Fortunately enough, neither Catalonia nor Spain are undergoing a traumatic political situation associated to the economic crisis that can be compared to the proclamation of the Second Republic in the case of the 1929 crisis and the dictator's death and transition to democracy in that of 1973.

As opposed to what occurred during the previous big economic crises, there is now effective international cooperation on which to rely. There is a will as well as institutions, but it is difficult to guess how this cooperation will be considered in some years from now – excellent, good, average or bad? In all developed countries, measures have been being taken for some months that were unimaginable not a long time ago as to direct governmental interference, attempting out-and-out economic liberalism upheld by some. However, nobody raises any protest against themselves, as

there is too much at stake. And President Roosevelt's «New Deal» is remembered with gratitude.

As of now, there are no serious symptoms of deflation as in 1929, despite the decline in oil and some raw material prices, which had previously experienced a considerable increase. But how prices will evolve in the near future remains to be seen. The crisis will encourage policies to reduce oil dependence, especially in the car industry.

Barack Obama's presidency may restore confidence in the United States and the world. And joint action of governments of the most developed countries is to be trusted as well, through either already existing institutions – International Monetary Fund, World Bank – or multilateral agreements between the US, the EU, Japan, China and other emerging countries. From our perspective, there are big expectations for the European Union to play its cards well: it is the first big economic crisis with this organisation and the euro as a big international currency around.

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Notes

1. JOAN SARDÀ. (1965). *Pròleg in La banca a Catalunya*. Barcelona: Edicions 62, p. 9.