# Catalonian economy must boost productivity

September 17, 2009

## Catalonia's economy is diversified and open, with an industrial base. But is it enough to ensure a strong competitive position?

Though the Catalonian region of Spain has a diverse, open, industrial economy, the current economic situation has exposed cracks in the business sector which would indicate that the current growth model is not very solid.

IESE's Public-Private Sector Research Center has conducted research on competitiveness in Catalonia in collaboration with the business association Foment del Treball Nacional. Professors Pankaj Ghemawat and Xavier Vives assess the actual state of the Catalonian economy: what prospects does it offer, and what steps must be taken to strengthen it?

## Growing on weak foundations

Several indicators suggest that the Catalonian economy has reached European levels. Using GDP growth per capita — measured in terms of purchasing power parity — as a yardstick, Catalonia, if it were a country, would rank somewhere between sixth and seventh place, or between Sweden and Belgium.

However, this per capita growth is not due to a rise in productivity, the levels of which are below the EU-15 average.

Instead, low interest rates, a large influx of immigrants, wage moderation and job creation were the factors that have allowed Catalonia to enjoy a period of extraordinary growth since 1996.

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But that trend is a thing of the past. In order for Catalonia to compete at the global level, it needs human capital policies, infrastructure, innovation and, above all, higher productivity.

The professors detect shortcomings in all those areas, which result in the following: a shortage of technicians and a surplus of university graduates; government investment in Catalonia that is systematically below the region's contribution to Spain's GDP; R&D spending and a ratio of patents per capita that are below EU-15 levels; and excessive regulations for businesses.

## Analysis of the causes

The results of the latest official PISA educational report set alarm bells ringing over the declining quality of educational standards in Catalonia. Reforms approved by the Catalonian parliament in July 2009 may correct some critical flaws in the system.

Besides education, the relationship between productivity, innovation and trade could be improved. In one chapter of the study, Ghemawat analyzes the evolution of two sectors: food and beverage, which is low-tech, and transport machinery, which is medium-tech. The former achieves better results in terms of growth in productivity, employment, profitability and external trade — a key factor in understanding the openness of the economy.

This shows that it is not just about embracing innovation per se but all the various mechanisms related to industrial revitalization as a means of boosting productivity. This is not to say that industry should give up on innovation; rather, it shows that there are other levers that can and should be pulled in order to increase productivity.

The study also examines the links between business and scientific innovation. R&D spending in Catalonia (1.5 percent of GDP) is below that of other leading countries or regions. Indeed, the EU-27 average is 1.8 percent of GDP. The National Pact for Research and Innovation has called for raising that spending level to 2 percent of GDP by 2010 and to 3 percent by 2017. Clearly, there is a significant challenge here.

## The public sector's duties

The Catalonian economy boasts several strong points, which the authors say should be leveraged to increase the quality of products and activities in the manufacturing and service sectors, to raise the productivity of small businesses and to help the region compete effectively in a globalized economy.

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The law on industrial policy that the parliament passed in June 2009 is an important first step, they say, because it paves the way for designing, participating in and carrying out a coherent policy in the industrial sector.

The authors propose an action plan to boost the competitiveness of Catalonia as a region. Among the recommendations are:

- *Education.* Give schools more autonomy and transparency, and institute a centralized exam for students and evaluation programs for the schools.
- *Innovation and internationalization.* Offer subsidies and tax incentives to encourage R&D, especially for small and medium enterprises, and improve coordination among agencies promoting internationalization.
- *Science and business links.* Encourage excellence and reform the structure of the system of science and innovation, which, in line with the Finnish model, should merge the different agencies that currently exist.

## Challenges for the private sector

The public sector isn't the only one with homework to do. Despite substantial integration of European markets and globalization at the world level, few Catalonian companies have managed to transform their strategies accordingly.

Companies are at a crossroads, the authors say. Maintaining competitiveness requires increased productivity. Just as governments must do, businesses likewise need to broaden their vision. Scientific innovation, for example, is one way, but it should not become the sole focus. Process, service and strategic innovations are just as important. "Innovation" must be considered in its broadest sense — achieving economies of scale and repeat innovations have proven to be successful.

In short, better coordination of government and private-sector policies, all aimed at boosting productivity, seems to be the best remedy for shoring up Catalonia's competitive position.

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