



Marcelo Fuentes, 2010. «After the Crisis» series. Watercolour (fragment), 17.5 x 14 cm.

# A NEW PRODUCTIVE MODEL?

## THE VALENCIAN ECONOMY: CHALLENGES AND ANSWERS

Salvador Gil and Vicent Soler

The Valencian economy is facing a major challenge that goes beyond overcoming a profound economic crisis: the sustainability of long-term growth. Knowledge, human resource training, innovation and continuous improvement in productivity are key to overcoming that challenge, in which entrepreneurs and governments play a crucial role.

The international economic crisis that began in the second half of 2008 is having a serious impact on Valencian and Spanish society and their economies, while it highlights very clearly the limits of the current production model. The year 2008 marks the end of a long phase of expansion lasting fourteen years, in which these economies have made substantial progress in the process of convergence, in *per capita* income, with the European Union average, although this convergence was facilitated by the entry of Eastern European countries with lower *per capita* income. There was also a marked reduction in the unemployment rate, reaching an all-time low of the last three decades in the second quarter of 2007 (7.95%, according to data from the Labour Force Survey, National Institute of Statistics).

So, without doubt, the current production model in recent decades has contributed in the early stages of economic prosperity to improving the welfare of our society, thanks to high rates of economic growth and job creation. However, there is also consensus that this is a technologically weak production model, with low productivity and is overly reliant on the residential construction sector, *i.e.*, very vulnerable, as demonstrated with the bursting of the housing bubble. All this is especially true in the case of Valencia, where, in addition, Gross Domestic Product (GDP) *per capita* has been below that for Spain, from which it which differs by nearly 12 points in the last fifteen years.

Currently there is an intense debate regarding the limitations of the Spanish production model (much

more pronounced in Valencia) and the need for a change of model. This debate, which is not at all new, has gathered special force over the past two years because of the particular impact the global crisis is having on our economies. To illustrate this fact it suffices to note that the unemployment rate in the second quarter of 2010 stood above 20% in Spain (20.09%), double the average rate of the European Union, and 23.84% in the Valencian economy (a percentage that exceeds by 16 percentage points the

figure for the same quarter of 2006, and which places the Valencian economy in third place in the order of regions with highest unemployment rate, just behind the Canaries and Andalusia).

We are, therefore, facing a major challenge that goes beyond overcoming a profound crisis of an exceptional nature. We face a structural problem: the exhaustion of a growth model whose past successes

have masked their weaknesses for the future and sustainability in the long term. Structural changes are feasible, as shown by the very history of the Valencian economy since the 1960s, but time consuming. There is no denying that these changes are already taking place, even in many traditional sectors, but it is also clear that the current production specialization is far from having changed enough to fit in with the present composite of factors and relative levels of labour costs. In this situation, how should we act? What should we change? What agents should lead the changes?

**«WE FACE A STRUCTURAL PROBLEM: THE EXHAUSTION OF A GROWTH MODEL WHOSE PAST SUCCESSES HAVE MASKED THEIR WEAKNESSES FOR THE FUTURE AND SUSTAINABILITY IN THE LONG TERM»**





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Training and knowledge are two main underpinnings of any production system. In this respect, knowledge transfer from universities to society should be a priority for all Governments. The picture shows a lecture theatre at the University of Valencia.

#### ■ THE EUROPEAN AND INTERNATIONAL CONTEXT

As a starting point, it should be noted that since the nineties, there have been major changes in the scenario faced by economic agents in Valencia, and that these condition the response, in a determining manner, and the public and corporate strategies that can and should be adopted. Among the more significant should be noted, firstly, the intensification of competition in the international context resulting from the progress made in European integration and economic globalization and, secondly, the emergence and development of the so-called Knowledge Society.

If the accession of Spain to the current European Union in 1986 marked a turning point, going from being in Europe to being within Europe, the advances that have taken place over the years in the process of European integration (deepening and extension) were also of great importance. Furthermore, to the achievement of the single European market in early 1993 we should add the adoption of the euro in 1999 by eleven European Union member states (joined by six other states in recent years). Both stages of the process of deepening European integration have meant increased trade and competition among the

participating countries and the latter also implies the impossibility of resorting to the devaluation of currency by the Spanish economic authorities as a mechanism of competitive gain.

On the other hand, with the last two enlargements of the European Union towards Central and Eastern Europe in 2004 and 2007, a number of countries with low labour costs but a highly skilled workforce have been incorporated, which, in addition to intensifying the competition faced by our companies in local and foreign markets, has resulted in a reduction in the structural and cohesion funds we receive from the European Union, which have been instrumental in modernizing infrastructures.

However, the increasing competitive pressures faced by the Valencian economy, do not only result from the progress in the process of European integration, but also from the significant advances in the integration of countries worldwide, as a result of agreements reached in the Uruguay Round of GATT (General Agreement on Tariffs and Trade) in the mid-nineties. As in the past, advances in globalization have affected many areas in addition to trade in goods and services such as investment or migration. This process has coincided in time with growing changes



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In addition to reinforcing or adding value to activities already under way in the production system, it is also necessary to plan for new sectors with high growth potential, innovation and technological development, such as renewable energy, eco-industries and biotechnology, among others.

in the geography of the competitive advantages derived from the trends of third countries, particularly the BRIC (Brazil, Russia, India and China).

Finally, one must include in the new scenario the technological revolution, which means the spread of ICT (Information and Communication Technologies). The Knowledge Society is closely related to production systems and their applications to lower costs and increased productivity in the whole economy, so that the future of many activities depends on the ability of companies to take full advantage of the opportunities for modernization and progress that new technologies provide. Let us remember that ten years ago the Lisbon Agenda already foretold that Europe should become a more competitive economy based on knowledge, building on new technologies and on the intensive use of human capital and productive activities.

#### ■ SUSTAINABLE GROWTH

In the present context, apart from achieving a set of objectives that are urgent and necessary in the short term, such as the recovery of economic growth, net job creation or restoration of the balance in public

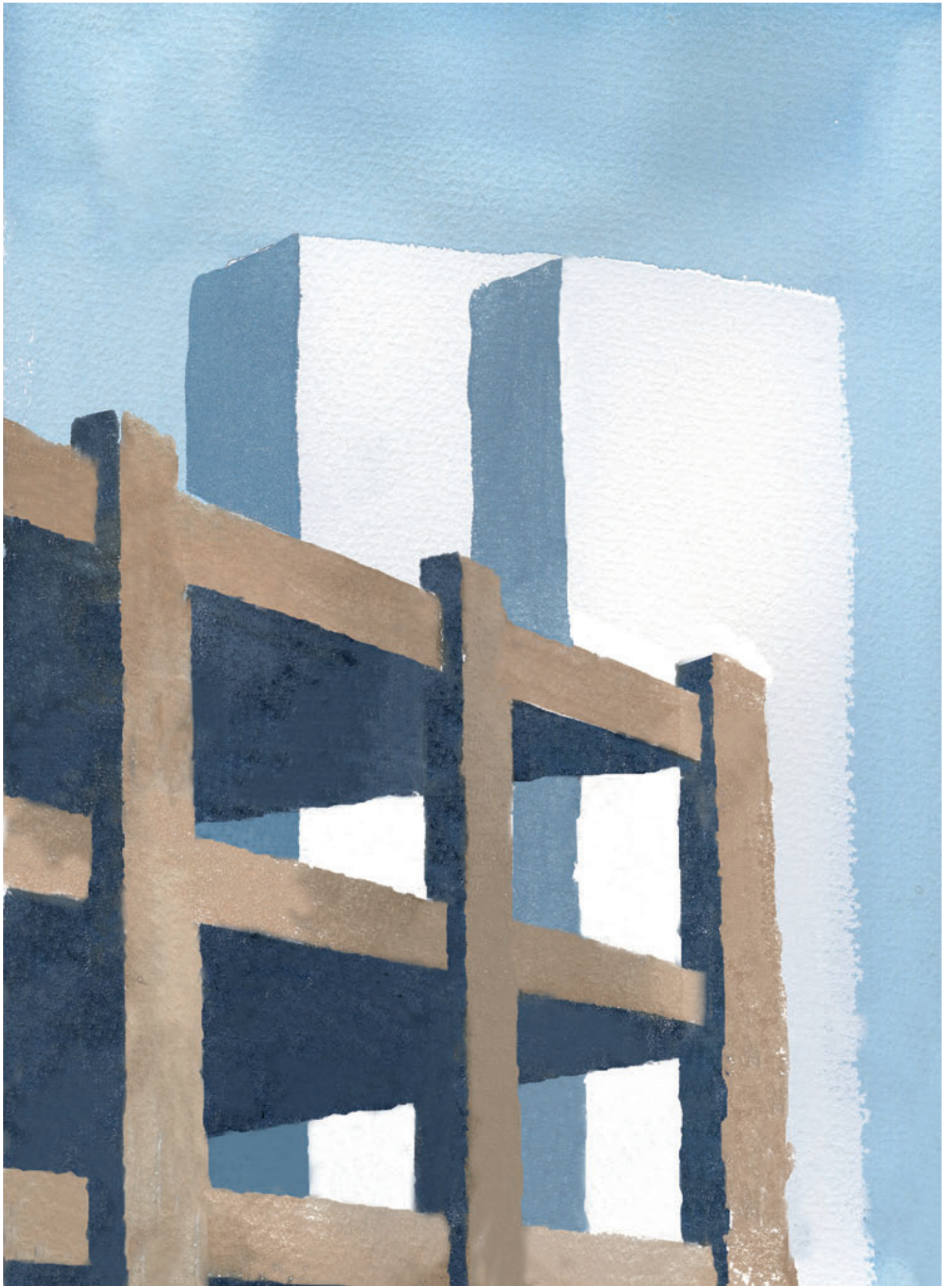
accounts, the Valencian economy should direct its production model to achieve medium to long term sustainable growth from three perspectives: economic, social and environmental.

To achieve economic sustainability, the production system should rely primarily on knowledge, training of human resources, innovation and continuous improvement in productivity. That said, we know that the Valencian economic structure continues to show a high specialization in the so-called traditional sectors and a scarce presence of activities classified as advanced. It is easy to agree that it is desirable to have a productive structure in which the latter type of activity predominates, characterized by enjoying a greater demand in growth in recent times and a high technological and knowledge content.

However, although the advantages of a production structure with a significant presence of these activities are obvious, if we adopt a realistic approach the answer to the challenge we face cannot involve a radical change in our production structure in the short term.

First, because production patterns cannot be established by law, nor expected to arise out of nothing. Employers and workers, particularly in a







context such as Valencia with a strong predominance of small and medium enterprises, have some skills and knowledge gained over time and which, to a large extent, are specific to the activity they exercise. For this reason, it is much more likely that the development of new activities will take place successfully when new products are related to those previously produced. On this point, there is reason for optimism because, despite the high prevalence of traditional sectors, the Valencian economy has a broad and diversified industrial base, which gives it great potential to develop new activities. It should be borne in mind that the concentration of certain productive activities in specific territorial areas can take advantage of the so-called economies of scale, external to the company but internal to the territory, which partly offset the limitations imposed by the small size of the average Valencian company.

Secondly, because often the change of model depends not on what we do but on how we do it. Within the various traditional sectors, progress is possible in terms of value added to goods and services by incorporating human capital and technology to production processes. Good examples of this can be found in several specific companies representative of traditional Valencian industries (ceramics, paving, footwear, textiles, furniture, etc.) that have taken advantage of the important role that intangible qualities such as knowledge, design, branding, R&D and innovation, quality, and so on, can represent. But there are also some interesting initiatives in service activities, such as those related to tourism or commercial distribution (the Valencian company Mercadona is considered as a case study in the most prestigious universities in the world) and even in sectors of agriculture or construction.

However, developing new activities similar to those we have been doing and progressing by adding value should not be an obstacle to the development of some new sectors if the conditions and the right incentives are established to enable home and foreign capital to be invested in a decisive manner. In this regard, the report *Ideas for a New Economy. Towards a More Sustainable Spain in 2025*, carried out by the Ideas Foundation, highlights seven new sectors with

high growth potential, innovation and technological development: renewable energy, eco-industries, information technology and communications, biotechnology, aerospace, cultural industries and social services.

Thus, in the proposed paradigm shift, the employer plays the key role in discovering and exploiting new opportunities in the domestic and international markets. However, the work of public administration is also central: to adopt all those micro and macroeconomic measures necessary to facilitate and accelerate the changes mentioned above. At the microeconomic level, government must promote a culture of innovation, facilitate entrepreneurship, promote growth to reach a size large enough to be consolidated in the medium and long term, encourage innovation through a well-designed public policy for R&D and innovation, facilitate knowledge transfer from universities

and research centres to the production network, promote structural competitiveness (cities, internationally renowned innovation networks...) and promote the internationalization of companies.

Also, for those activities to fully take off, they must be accompanied by macroeconomic enterprise and develop in a favourable institutional environment. To achieve this, economic policy makers, as

well as ensuring macroeconomic stability, providing (wisely) social and productive infrastructure and an efficient education system of quality, which trains professionals needed by companies, should facilitate market efficiency (by removing barriers to competition) and design a labour framework that adequately combines the protection of workers' rights with more flexible adaptation of business to a constantly changing economic environment. ☺

**«TO ACHIEVE ECONOMIC SUSTAINABILITY, THE PRODUCTIVE SYSTEM MUST BE BASED MAINLY ON KNOWLEDGE, INNOVATION AND A CONSTANT IMPROVEMENT IN PRODUCTIVITY»**

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On the left, Marcelo Fuentes, 2010. «After the Crisis» series. Watercolour, 16 x 21.3 cm.