

REFLECTIONS COVID-19

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SOCIOECONOMIC IMPACTS OF COVID-19: REFLECTIONS FROM THE BASQUE COUNTRY

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EXECUTIVE SUMMARY

This document brings together key aspects of a process of reflection and analysis that Orkestra set in motion when the COVID-19 crisis broke out. It is a living document that aims to support public decision-makers, particularly at regional level. The document identifies and focuses its analysis on two stages that require different responses with respect to the socio-economic impacts of the pandemic. The first is a **resistance stage** in which macroeconomic and regulatory policies take precedence. The second is a **reconstruction and renewal stage** that demands proactive policies to build regional resilience.

During the **resistance stage**, policies should be oriented towards solving the health crisis and avoiding the destruction of productive capacity and employment, while observing three criteria: **timing, prioritisation and risk sharing**. Flexibility and proximity to actors in the industrial ecosystem, as well as the existence of a rich network of intermediate organisations, are factors that contribute to the good use of public policies in this stage.

With regard to the potential **microeconomic impacts** during the resistance stage, a number of determining factors are identified, including:

- measures taken by governments to force the closure of certain activities;
- the degree of insertion in global supply chains;
- the degree of servitisation of companies;
- the degree and sophistication of business digitisation; and
- the financial health of companies.

A section is devoted to the **financial health of companies**, highlighting the fact that Basque companies are facing the resistance stage in relatively good condition, due to the solidity of their balance sheets, the recovery of profitability and the reduction of their financial vulnerability. However, the evolution of this panorama will depend on the firms' size, segment and sector.

Due to its importance for the competitiveness of Basque industry, the effects of the crisis in the **energy sector** are analysed. In the short term risks are related to the disruption of global supply chains and uncertainty with regards to production capacity. In a few months' time, the main risk to the sector will be associated with delays in the construction of new facilities and infrastructure projects around the world. On the other hand, opportunities are also opening up for the electronics and power electronics sectors and for companies in the oil & gas value chain.

With regard to the **reconstruction and renewal stage**, five key considerations are identified for the formulation of proactive policies:

1. **Timing**, the success of which depends on having a diagnostic analysis of which sectors, companies and people are affected and at what times, as well as working with different scenarios;
2. The opportunity to address **major structural challenges**, such as the climate emergency, demographic transitions and the digital revolution, which are clearly interrelated with the impacts of COVID-19 and with the responses that this crisis requires;
3. The balance between **global and local**, which offers an opportunity to redefine value chains and to advance in sustainable transition from a production perspective;
4. The balance between the **return to normality** and the **reorientation** of activities, with the possibility of exploiting the potential of concepts such as the collaborative economy, teleworking, virtual reality, or robotic manufacturing;
5. The need for renewed **collaborative frameworks** between businesses, governments, universities and citizens, supported by intermediary organisations and platforms.

Based on these elements, the document concludes with a series of recommendations aimed at developing capacities and instruments to adequately understand each stage of the process and its specificities.

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1 INTRODUCTION

The immediate and primary focus of the COVID-19 pandemic is the health crisis we are experiencing and the responses from governments, health systems and citizens to manage that crisis and save lives. Nevertheless, the health crisis has important impacts on socioeconomic development – in the short, medium and long term – to which we must also formulate responses.

This document presents the initial results of a reflection process that Orkestra, as a research centre focused on sustainable territorial competitiveness, launched as the COVID-19 crisis accelerated at the end of March 2020. It aims to contribute to the decision-making of public policy-makers through analysis of the main socioeconomic impacts and responses to the crisis in the specific context of the Autonomous Community of the Basque Country.

From a socioeconomic development perspective this crisis can be conceptualised in two stages: (i) a stage focused on **pandemic resistance** and (ii) a stage focused on the **reconstruction and renewal of our economy and society**. We currently find ourselves in the first stage, in which the economy and society no longer operate within parameters considered as "normal" and in which an important part of their activity has been "paused". At this stage the focus is on reactive policies that support companies, other institutions and citizens in their efforts to survive the shock and minimise its consequences in the short term. This document presents and analyses these measures. However, soon we will move to a second stage of reconstruction and renewal. For this reason, it is important at this time to not only reflect on short term reactive measures, but also on reconstruction and renewal measures that must be designed now so that they are effective in the medium and long term.

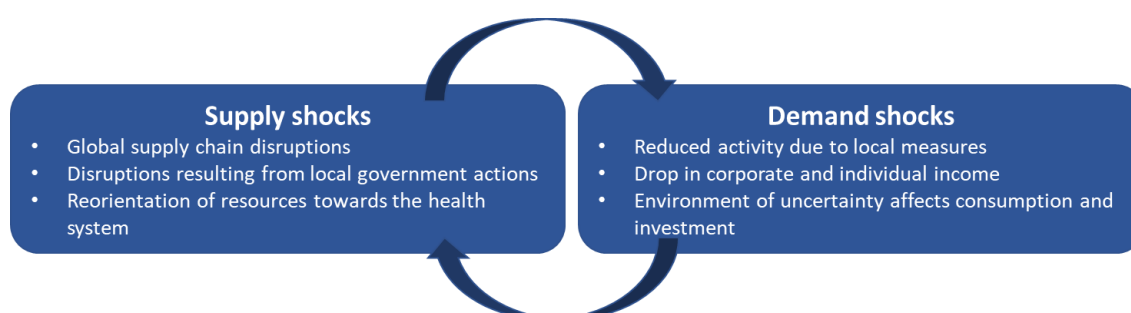
Our analysis responds, therefore, to the question: How can we prepare ourselves today to address the socioeconomic crisis of the future as a result of COVID-19? As such this document is a starting point in a process aimed at framing the socioeconomic effects of COVID-19 in the Basque Country to support Orkestra's various stakeholders in their own action-oriented reflections. This starting point poses, on the one hand, an overall framework for the interpretation of what is happening and what is likely to happen in the coming weeks and months. On the other hand, it shows how the resistance stage is being developed and reflects on different dimensions that should be taken into account for the reconstruction stage.

In the context of the process started by Orkestra with this document, the proposed framework will be used in the near future to provide more in-depth analysis of the impacts of the crisis and potential responses that could develop throughout 2020. This analysis will be aimed at the specific needs of regional stakeholders in the Basque Country.

2 CONTEXTUALISATION OF THE SOCIOECONOMIC CRISIS

COVID-19 has caused an unprecedented situation on a global level.¹ The spread of the coronavirus through different countries and the tension that this places on health systems, as well as the high humanitarian and social costs, have generated a **global crisis that is not comparable** to previous economic or financial crises. Not only are we facing a health crisis with great impact, but also an associated **socioeconomic crisis**. In fact, the coronavirus as an external factor progressively leads to economic shocks on both the supply and demand sides, which feed off each other (see Graph 1). The severity of this cycle can be even greater if it becomes accompanied by a crisis or collapse of the financial system.

Graph 1 Supply and demand shocks



Source: Own elaboration

Given this situation there are two immediate priorities in the first stage of "pandemic resistance":

1. Solve the health crisis, devoting the economic resources and attention that is necessary to do so, even if that means deepening the socioeconomic crisis in the short term.
2. Endeavour to minimise the economic, social and emotional destruction resulting from the crisis as much as possible.

If the current crisis is compared to the economic crisis of 2008 (see Table 1), we can see that they are caused by different factors and affect different geographic and activity areas. Alongside the global nature of this crisis, it can be observed that some sectors experience a greater negative impact, while other activities even experience an increase in demand (certain technologies, online shopping and distribution, the food and beverage sector, digital entertainment ...). Similarly, some countries will initially experience a more negative affect than others. This is the case of Spain (and, with minor variations, the Basque Country) due to the higher degree of aging, its dependence on the economic sectors most affected by the crisis (the hotel industry, restaurants, transportation, automotive ...), a greater presence of SMEs and the high rate of temporary employment and non-standard employment. On the contrary, other aspects may work in their favour, such as the (still) relative strength of its health system, which is not the case of countries like the US or UK.

Another key fact that differentiates the current crisis from previous crises is the potentially temporary nature of the decline in activity. Indeed, it is possible that productive activity that doesn't become bankrupt may become operational again quickly once the health crisis is over. In this scenario there are two elements that could make the economy more prone to a relatively rapid recovery from this crisis. On the one hand, the **level of corporate indebtedness** is much lower at the present time because Spanish firms have reduced their indebtedness over the

¹ The Managing Director of the International Monetary Fund, Kristalina Georgieva, announced on 3rd April that "*this is a crisis like no other. Never in the history of the IMF, we have witnessed the world economy coming to a standstill. We are now in a recession. It is way worse than the global financial crisis.*" See: <https://www.imf.org/en/News/Articles/2020/04/03/tr040320-transcript-kristalina-georgieva-participation-world-health-organization-press-briefing>.

last decade. On the other hand, the **banking sector** is considerably **more capitalised and healthier** than it was during the previous crisis.

Table 1 Comparative characteristics between crises

	Great Recession (2008)	CRISIS OF COVID-19 (2020)
Origin	Internal Financial crisis → supply and demand shocks	External Health → supply and demand shocks → financial crisis?
Geographical area	Regional Originated in USA and expands to EU	Global Originated in China and gradually expands to everyone
Sectors most affected immediately	Construction and banks	Certain services (hotel and catering, tourism, transportation, entertainment, shopping, education) and industry integrated into global supply chains
Job losses	Permanent (in the concerned sectors)	Temporary (in the concerned sectors), but potentially can become permanent and/or extended to other sectors
Banking sector	Under-capitalised and under-supervised nationally	More capitalised and supervised by the ECB
Business debt	Very high	Moderate
Global supply chains	In general, they were strengthened through the crisis	They are being disrupted by the crisis and may be weakened
Exchange rate	A rise in the Euro with depreciation prospects	A small rise in the Euro, with no prospect of depreciation
Monetary politics	Leeway for traditional instruments ($i = 4\%$) Use of non-traditional instruments: taboo	No leeway for traditional instruments ($i = 0\%$) Use of non-traditional instruments: mass regular bulk purchases of debt, and arguments for the monetisation of deficits
EU fiscal policy	Little impact (spending: 1% of GDP)	Potential for significantly more incidence: A \$540 billion package has been approved to provide safety nets for workers, businesses and Member States ²
National tax policy	Healthy situation: budget surplus (+ 1.9%) and moderate public debt (35.8%) Social Security surplus No risk premium Budget stability rules	Not very healthy situation: budget deficit (-2.3%) and large public debt (96.6%) Social security deficit Risk premium (150 points, 18th March) Temporary abandonment of budget stability rules
Basque tax policy	Fiscal surplus, no debt and no stability rules	Budget balance, public debt and moderate stability rules
Labour market	Moderate employment protection and high temporality	Low employment protection and high temporality

Source: own elaboration

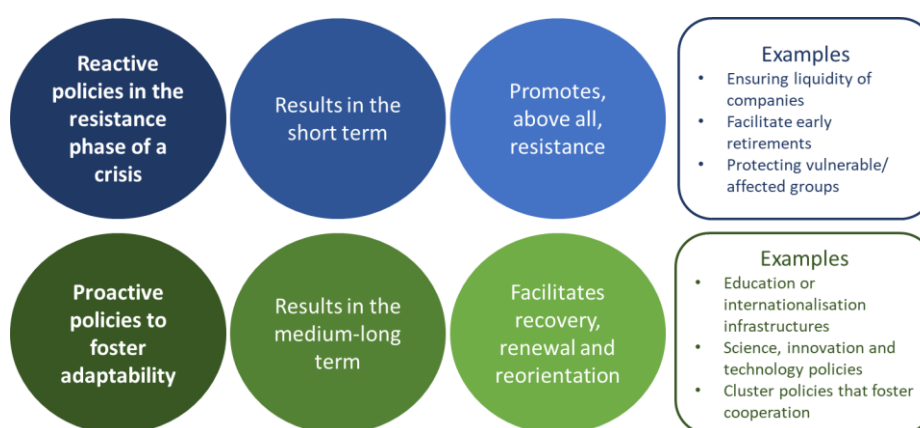
² The package was approved on 23rd April and should be operational by 1st June. See: <https://www.consilium.europa.eu/en/policies/covid-19-coronavirus-outbreak-and-the-eu-s-response/>

Although this crisis is unprecedented for the singularities described above, the literature on territorial resilience can provide frameworks for reflection and action.³ In particular, the concept of **regional resilience** has different dimensions that can be useful to understand the crises caused by external shocks:

- Resistance: the ability to resist an external impact or shock
- Recovery: the speed and the type of recovery after a shock
- Renewal: the resumption of the growth path which existed before the shock
- Refocusing: the adoption of a new growth path

While the literature emphasises specialisation and productivity as explanatory factors of regional resilience, there is also a strong consensus on **the importance of institutions and policies** with regards to external shocks. Among the kinds of policies that foster the resilience of territories two main groups can be distinguished (see Graph 2).

Graph 2 Two types of policies that foster resilience of territories



Source: compiled by authors

The combination of these two types of policies explains the regional growth path of the Basque Country, a territory that has demonstrated a greater resilience to financial and economic crises and/or structural changes than other Spanish regions in past decades. Many of the reactive policies depend on other administrative levels (for example, the monetary policy of the ECB). However, a large part of the adaptability policies related to business competitiveness, innovation and digitisation and structural transformation of the economy, depend on the subnational level. This is especially true in the Basque Country, where almost all related policy competences are held at regional and/or sub-regional level.

Finally, literature and analysis of previous crises show the importance of **collective action and coalitions of actors** for the implementation of measures to promote regional adaptability. In other words, if we are currently facing a mission of a global nature, then the ability to cope in the short term depends on a joint response that is coordinated at the institutional level, *and so does* the ability to build resilience capacity to face future challenges in the medium and long term.

³See, for example: Bristow and Healy, 2014; Boshma, 2015; David, 2018; Martin, 2010; 2012; Magro and Valdaliso, 2019; Magro *et al.*, 2020.

3 POLICIES FOR THE RESISTANCE STAGE OF THE PANDEMIC

In the initial resistance stage, alongside taking necessary measures to resolve the health crisis as quickly as possible, remaining attention should be placed on **avoiding the destruction of productive capacity and employment** by temporarily adopting the necessary measures. The economic policies best suited to such actions in the short term are macroeconomic and regulatory policies. In particular, it is important to ensure that the demand and supply shocks previously mentioned are not accompanied by a **collapse of credit**, which would accelerate the destruction of productive capacity. While in the short term macro and regulatory policies prevail, their application should be based on three key elements:

1. **Timing:** measures relevant in the resistance stage, may not be valid for reconstruction and/or renewal
2. **Prioritisation:** resources are limited and not all sectors and agents are being hit in the same way, nor are they equally relevant or strategic
3. **Sharing risks:** for equity reasons and to avoid the emergence of perverse incentives

There are three main macroeconomic policies: fiscal, monetary and exchange rate policy. The role that corresponds to each level of government in its handling is different. Monetary and exchange rate policies (being two sides of the same coin) totally depend on the European institutions. Fiscal policy, however, depends above all on the Member States, although under pressure from those States most affected the EU is also developing fiscal measures of some relevance (see Table 1). While fiscal policy remains fundamentally a national competence, in some regions (especially in the Basque Country) a significant level of decentralisation has been achieved and subnational governments also have a say in this respect. Finally, in regulatory matters the level of decentralisation developed in Spain is very limited, and key areas to address the crisis, such as the regulation of the labour market, is still an exclusively national competence.

Table 1 shows the very different situations of the Spanish and Basque economies with respect to macroeconomic and regulatory policy responses as compared to 2008. In brief summary, we should not expect a marked depreciation of the euro in the near future so that exchange rate policy plays the favourable role that it played after 2008. The traditional instruments of **monetary policy** are already practically exhausted, but **non-traditional instruments** (massive purchases of title funds and even possible monetisation of public debt) **can be of great help**, especially if used to counter possible attacks taking place on the risk premiums of countries like Italy or Spain (likely to rise due to policies adopted to address the crisis). Regarding **fiscal policy**, the situation of the public accounts implies that Spain has more limitations than countries such as Germany (with its *bazooka* plans), although measures have been taken to try to mitigate the economic impact on businesses and households in the short term. Indeed, Spain is facing the risk of incurring heavy debts that could be targeted in financial markets (especially if they are not backed by European institutions) and thus place substantial constraints on future public policies. That is not the case for Basque fiscal policy. Although smaller in dimension in absolute terms, **Basque institutions have a certain margin for fiscal policy having carried exercised constraint** over the last five years. The Basque Country is currently in a situation of balance or small budget surplus and has a public debt level of around 13%.⁴

When it comes to activating the economy, if we leave aside the measures aimed at strengthening the fight against the disease (for example, support for research into COVID-19), the measures taken by the Spanish Government have so far been very similar to those put into place by other European countries and quite in line with what has been recommended by experts:⁵

- **Support for workers, families and vulnerable groups** (mainly by extending unemployment benefits)

⁴ See: Alberdi and Olalde (2020)

⁵ See: Jansen and Jimeno (2020)

- **Temporary activity adjustment mechanisms** (the temporary redundancy programme, *ERTE*) to avoid redundancies
- **Public liquidity guarantees** to sustain economic activity due to the temporary difficulties arising from the situation
- **Other measures of flexibility** (concerning the management of agreements with the public sector and the governing bodies of listed public limited companies)

Interventions of Basque institutions to address the crisis have been conditioned by their level of policy competences and resources. In the health field, a core area of responsibility and one in which the Basque Country has invested strongly, the response has been outstanding. In the tax field the response has been very quick, agile and even more generous than that applied in Spanish territories under the common tax regime (although there is room for improvement in the coordination of the measures of the provincial institutions). Moreover, **measures have been implemented to ensure the liquidity of businesses**, supported by organisations such as the Basque Institute of Finance or *Elkargi*, and without ruling out that in the future direct holdings in strategic companies may arise (for which instruments are available, such as *Bideratu*).

While it lacks legislative powers in the labour market field, the Basque Government is the competent authority for the administrative processes pertaining to companies operating in the Basque Country. Similarly, although there is a lack of competence in Social Security, the Basque Government developed various mechanisms to support people without a minimum income (Minimum Income Guarantee and Complementary Housing Benefit, among others), as well as an increase in Social Emergency programs that can play a key role in the crisis.

Finally, on the regulation of activities, the Basque Government was one of the first to react and enact measures to close certain activities when the crisis arose; and after the rapid expansion of these measures it has established protocols for possible application in companies so that they are not forced to close during the pandemic and/or so they can reopen rapidly.

4 POTENTIAL MICROECONOMIC IMPACTS DURING THE RESISTANCE STAGE

4.1 Which sectors will be most affected?

It is likely that the coronavirus will have consequences for all businesses in our economy. A first direct impact derived from the suspension or reduction of activity is the processing of redundancy programmes (*EREs*) and temporary redundancy programmes (*ERTEs*), with almost 22,400 files processed and more than 153,000 workers affected at the beginning of April 2020.

However, it is also likely that there will be certain business groups most exposed to its consequences. Two clear examples, frequently referenced by the press, are air transport companies and the hotel industry. The rationale behind these cases is their heavy dependence on the mobility of people, which has been significantly reduced.

But just like people, goods are also immobilised (final and intermediate products, raw materials and the like). This implies that the **supply chains in which many companies in our territory are embedded are paralysed**. Accordingly, those companies that have externalised / internationalised / outsourced production activities, those whose provisions rely on cross-border supply chains and/or apply methods such as Just in Time (JIT) and Lean Production may be the most affected (see Table 2).

Because of the central role that many Chinese companies play in the supply chains of other companies, the impact is being felt worldwide. This disruption is particularly acute in the electronic and automotive industries.

The coronavirus pandemic will push corporations to weigh up the efficiency and cost/benefit of a system of global supply chains against the strength of domestic supply chains. Opting for the latter would reduce the reliance on a global supply system increasingly fractured.

(Shih, MIT SMR, 2020)

It is surprising that, although there is a perception that products move and are exported easier than services, in times of recession product sales (especially durable goods) are reduced more than services. During an economic setback the users of durable / capital goods often defer new purchases. This is clear both from macroeconomic studies analysing the ups and downs in income from the sale of products and services during the 2008 financial crisis, as well as from business cases that show that **servitisation** helps mitigate the negative effects of an economic downturn.⁶ This suggests that manufacturing firms that have not invested significantly in the services business may suffer more.

At the aggregate level we see that the service component grows from 1% of the total industrial turnover in 2000 to represent 2% in 2015. At the level of individual subsectors, we observe values of up to + / -3% for electronic equipment and metal stamping and almost 5% for the machine tool.

(Kamp and Sisti, 2018)

In a similar way, we can observe that in uncertain circumstances such as those produced by the present crisis, unlike activities intensive in labour, digital products and activities can continue to operate and can reach their markets more easily than tangible products. Thus, the **degree of digitisation** of businesses and business activities by sector are also variables that allow us to estimate the vulnerability by industry and firm (see Table 2).

⁶See: Cusumano *et al.* (2015)

Table 2 Global supply chains and degree of digitisation

Sectors in the Basque Country most dependent on imports (more than 40% of their inputs)	Sectors in the Basque Country with an intermediate demand for Information, Electronic and Communication Technologies (IECT) below the average (and declining)
Cokeries	Postal and courier activities
Basic chemistry	Waterborne transport
Paints	Gas, steam and air conditioning
Non-ferrous metals	Furniture manufacturing
Rubber	Hotel industry
Gas	

Source: Compiled by authors based on data from Eustat and Zubillaga and Peletier (2019, 2020)

4.2 What are the implications for the energy sector?

In the energy field, the main risks in the short term for Basque industry are related to the disruption of global supply chains and uncertainty about production capacity.

Value chains in the Basque energy sector with better positioning in global markets and more relevant contribution to GVA – especially wind power, power grids and power electronics – have been affected to a greater or lesser extent due to the **interruption and/or slowing of the global supply chain of materials and components**, especially from China. This appears cyclical and part of the associated risks may be managed thanks to the flexibility that supply contracts offer (for example, *force majeure* clauses, the possibility of the renegotiation of certain terms, etc.), both upstream and downstream.

Some sectors, such as refining, will also suffer a sharp fall in demand for conventional transport fuels and oil derivatives used as inputs in other production processes in the short term. All this will also have an **impact on tax revenues** linked to these energy products.

In the medium term, the **fall in electricity and natural gas prices** favours, in principle, the Basque energy-intensive industry (e.g. mining, chemical, refining, minerals, metal, etc.) in terms of releasing financial resources. However, it should be noted that the transfer of the fall in wholesale prices to retailers will not be immediate and falling energy prices will tend to be widespread throughout the world and similar in the European countries around us.

Within a few months, the main risk is probably the **delay in construction projects of new facilities and infrastructure** worldwide. In the case of wind energy (and, to a lesser extent, photovoltaics), the risk is that companies with EPC (engineering, procurement and construction) contracts such as Iberdrola, Siemens Gamesa, etc., suffer delays in construction projects for new facilities. This could result in penalties (depending on the contracts with the premise owners) as well as increased costs, increasing pressure on the segment of Basque SMEs that produce components in the middle and lower reaches of the value chains, both on the side of costs and with regards delays in orders.

In the following months, **opportunities for the Basque energy industry** will appear. The electronics and electronic power components sector, for example, can position itself to meet unattended demand for Asian wind and photovoltaic system component companies (e.g. investors, trackers, etc.). On the other hand, the fall of the price of natural gas could result in new business sources for the companies of the oil and gas value chain in the Basque Country (e.g. manufacturing of pipes and other components of production facilities) if this fuel continues to be more competitive than coal and decarbonisation policies are maintained in Asia and other parts of the world.

This crisis is also an opportunity for all companies in the various value chains in the energy sector to revalue their level of dependency on supplies (materials and components) from Asia and value the convenience of diversifying its supply channels. The **ability to offer comprehensive solutions** in areas such as renewable energy and electric grids by the various value chains in the Basque Country could be put into value.

4.3 How will it affect the financial health of Basque companies?

Of course, if there is an interruption in transactions for inputs, parts, components and finished products, sales and corporate earnings will also be affected. Thus the financial health of companies and how it evolves during the current period of uncertainty also comes into play, especially if the resistance stage lengthens.

The financial situation of Basque firms is determined by their starting position, the economic risks of the shock and the effectiveness of measures taken to counteract the crisis. At present, and indefinitely, we find ourselves in the resistance stage, where the objective is that the least number of businesses are affected so that their viability is not threatened. **Basque firms face this in "relatively good conditions"** given the positive developments in recent years (latest available data 2018):



The strength of balance sheets has improved, with greater weight of equity (equity accounts for 33.3% of the balance sheet, 3 pp more than 2013) and a lower debt burden (financial debt represents 29.3% of the balance sheet, 4.3 pp less than 2013).



Profitability has recovered (ROA 3.0%, 1.6 pp more than 2013). This recovery has been greater in the industrial sector (ROA 3.6%).



Financial vulnerability of firms has been reduced by 9.2 pp since 2013, with only 27.6% of companies considered vulnerable.

This general situation can hide different realities, depending on the size or sector of the company. An example of this is that in **micro and small enterprises** the proportion of **vulnerable** companies is twice that of medium and large enterprises. On the other hand, sectors such as **hospitality, construction and trade** account for a significant amount of employment (8%, 6% and 17% respectively) and have relatively high vulnerability indices.

The COVID-19 crisis will affect many companies who will suffer from an impaired income statement, reduced solvency and compromised liquidity. It is necessary to create mechanisms to **identify those companies that were already in a difficult situation before the crisis** as this will help prioritise efforts towards those companies that, being in a good situation, are dragged into the current crisis. Although it is risky to anticipate all the problems that COVID-19 will generate in the financial sector, we can identify the main ones:



In most sectors there will be a **decline in sales**, so it is likely that there is a significant deterioration in profitability and that many companies incur losses.



Firms' **provisions on assets**, both fixed and working capital, will increase to reflect impairment losses and a possible **increase in defaults** within the system.



Firm liquidity can be compromised due to an increase in defaults and an increase in stocks that cannot be sold which will generate liquidity tensions.

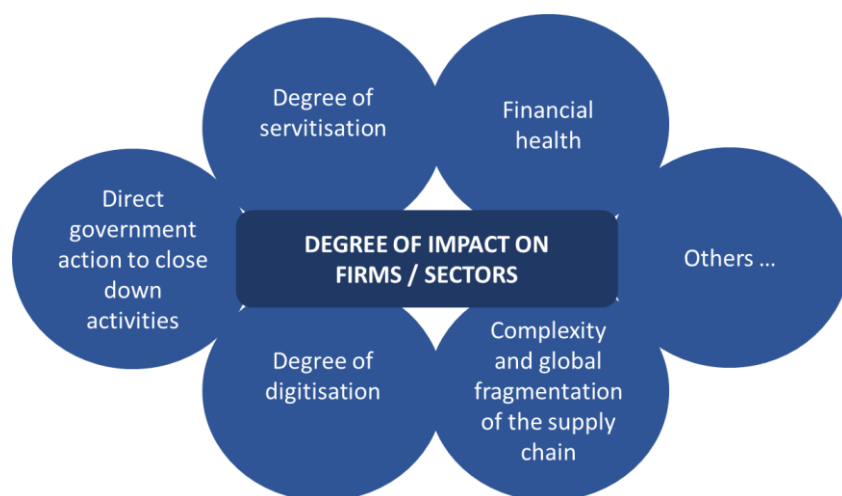


Firm **solvency and guarantee ratios** will deteriorate due to losses, provisions made, and the need to increase **debt to fund liquidity needs**.

4.4 Summary of the main axes that will determine the impacts during the resistance stage

In summary, in addition to the measures adopted by governments to force the closure of certain activities during the resistance stage, four other principal factors can be highlighted that determine the microeconomic impacts during this first stage (see Graph 3). Each one has room for more in-depth research with regards to the impacts and responses in the short term, as well as the evolution of these impacts in the medium and long term, and the most appropriate actions to prepare the ground for the reconstruction and renewal stage.

Graph 3 Synthesis of the factors analysed in relation to their impact on businesses



Source: own elaboration

5 TOWARDS THE RECONSTRUCTION AND RENEWAL STAGE

In the previous sections of this document, after contextualising the socioeconomic crisis associated with COVID-19, we have analysed the policies implemented as a first reaction to it and the microeconomic impacts that can be anticipated for this pandemic resistance stage. This section turns the focus to the reconstruction and renewal stage, its possible features, and the opportunities it can offer for socioeconomic development of a territory such as the Basque Country. The question to be addressed below is: ***What should be kept in mind to pave the way for the renewal of the economy and society once the health crisis is under control?***

In the second section two types of policies promoting regional resilience were highlighted: reactive and proactive. With regards to reactive policies Basque institutions are showing a more active level of response to those of institutions in other autonomous communities, which is the result of both a higher level of policy competences and greater experience and skills in the design and implementation of industrial and economic promotion policies. Greater flexibility and proximity to agents and the productive system, as well as the existence of a rich network of intermediate organisations, are enabling the three aforementioned criteria for the good use of public policies (timing, prioritisation and risk sharing) to be applied rather successfully during this resistance stage.

However, in view of the next renewal stage ***proactive policies to encourage adaptability*** take on greater importance. Moreover, it is here where responses at a regional level are particularly relevant. It is in this stage where it is possible to develop actions to strengthen business competitiveness and innovation, and to promote the structural transformation of the economy. In addition, the historical analysis of previous crises clearly shows the importance of keeping the focus on the medium and long term, for example, through **R&D, innovation, education or key infrastructure investment policies**. These investments in the adaptability capacity of the territory will be critical not only for an effective recovery from the socioeconomic crisis triggered by COVID-19, but also to prepare for future crises. In this sense, there is a growing consensus that austerity must be left behind, not only in short term responses to this crisis, but also in the medium term.

5.1 The timing is key

As the transition from the resistance stage to the renewal stage approaches, timing becomes a key element for the success of policies. Necessary and effective actions to protect businesses and/or vulnerable individuals during the resistance stage can be counterproductive just a few weeks or months later. In this sense it is necessary, on the one hand, to have good **diagnostic analyses** on which sectors, companies and individuals are affected and at what times. On the other hand, since the trajectory of this transition is not predictable, it is important to work with **different scenarios** to respond quickly to emerging circumstances.

For example, while it is clear that we will enter a recession – with some predictions anticipating a drop in GDP almost unprecedented – for now it is impossible to know whether this recession will be V-shaped (rapid recovery), U-shaped (soft recovery) or L-shaped (little recovery in the medium term). Each of these scenarios – along with their determinants – have different implications regarding which sectors will be affected, to what extent and at what times, all of which influences the effectiveness of different policies at different moments in time.

5.2 An opportunity to tackle the major challenges of our society

Regardless of the shape of the recession, it is clear that there will be a 'before' and 'after' with respect to COVID-19: **our economy and society will not return to the situation prior to the crisis**. In this sense we can interpret COVID-19 as what has been referred to in the literature on sociotechnical transitions as a landscape shock.⁷ The features of the probable changes provide a major opportunity to focus **adaptability policies to address several major structural challenges** affecting our societies. Challenges such as the climate emergency, demographic transitions and the digital revolution are clearly interrelated with the impacts of COVID-19 and with responses that this crisis requires.

⁷ A shock to our social, technological and ecological environment (see Geels and Schot, 2007).

In fact, the green and digital transitions are the two key levers of the new industrial policy of the European Commission, which is committed to transforming the EU economy for a sustainable future (the Green Deal).⁸ In this context we must recognise that we have a chance to advance in the global process of sustainable transition. The COVID-19 crisis provides several **levers to seize the opportunity**. The most obvious are the increased productivity resulting from new forms of work organisation, the reduction in emissions by increasing teleworking and decreasing in-person activity, and patterns of sustainable consumption promoted by the relocation of value chains, requiring less energy and material consumption. Changes in rules and regulations – and our interpretation of them – can lead to the **acceleration of profound changes in existing sociotechnical systems** in the areas of health, food, communication and mobility, among others.

In addition, a consequence of the crisis generated by COVID-19 is that the **capacity of resilience and adaptation** of governments, the socioeconomic system and society in general **becomes more visible**. This may have a positive effect when facing challenges and problems that our system has been grappling with for a long time, as it may help us reassess if our production, economic and social models are aimed at objectives that are outdated.

5.3 *What combination of global and local?*

The future of globalisation is one of the cornerstones of this rethinking that is already provoking debate. At this very moment **a globalisation pendulum effect** is taking place which is reflected in the closure of borders and disruption of global supply chains that have been built gradually over the past 30 years.

In the short term we are returning to the local. This process is visible especially in the reconstruction efforts of local value chains for the manufacturing of goods demanded by the health system to address the health crisis. In the medium term it is possible that the pendulum will quickly return to its previous position, reopening global supply chains with the same speed at which they were closed. However, it is likely that we will need to live with the coronavirus for a more sustained period of time and that it will not be possible to reopen quickly, at least in certain sectors. These circumstances, combined with acknowledgement of the possibilities and advantages of more local supply chains with respect to digital and ecological transitions, can make the changes towards more closed models of economy and society become more permanent.

The most likely scenario is intermediate, with some sectors and activities rapidly reopening and others consolidating new value chains based on more local relationships and/or the use of new technologies. In this sense **the redefinition of value chains is presented as one of the major opportunities to advance in sustainable transition from a productive perspective**. It is a matter of, in addition to reducing energy and material consumption, building robust and resilient chains. The application of technologies such as the Internet of Things (IoT), 3D printing or blockchain, can be key when providing greater traceability and transparency to new value chains. This transparency may also benefit the development of the circular economy and the so-called sharing economy.

5.4 *Combination of "business as usual" and the refocusing of activity*

Value chains are not the only element that will face the uncertainty of the pendulum motion in the reconstruction and renewal stage. In this context of interaction between local and global forces within the framework of significant structural challenges, there are many socioeconomic activities that may reconsider the balance between "business as usual" and a refocusing strategy.

In the economic field, for some sectors and activities the return to their "normal" activity may be relatively easy or desirable, while for others it will be difficult and/or undesirable. A positive aspect is that there is already a lot of knowledge about how to do things differently – concepts like the collaborative economy, teleworking and virtual reality, telehealth and robotic manufacturing – and it is likely that the use of these technologies and models will

⁸ See: European Commission (2019, 2020). It remains to be seen whether the ambitious investment financing plan included in the European Green Deal will be affected in the short and medium term by the coronavirus crisis, but several countries have formally called on Brussels to make the European Green Deal the great lever for reviving the economy. See: <https://www.lavanguardia.com/natural/20200409/48399290890/diez-paises-teresa-ribera-pacto-verde-european-green-deal.html>.

accelerate in the renewal stage. Again, **the possibilities and impacts will differ by sector, depending on the timing and depending on the scenarios that emerge**. The complexity of this process underscores the challenge for policy makers to develop strategic intelligence and agility to support reconstruction and renewal through introducing and adapting measures at the most opportune moments.

The return to normality should, necessarily, involve a recovery in employment that guarantees a level of social stability (and also economic stability, through aggregate demand) during the reconstruction and renewal stage. An assessment must be made of the extent to which there is a trade-off in the short and medium term between employment support measures oriented to generate employment fast (and possibly more spending oriented), and measures aimed at investing in clusters, value chains and areas in which the Basque economy has focused its specialisation and competitiveness strategy (for example in the field of health or energy). To this end, answers must be found to questions such as which policies can most effectively help employment in the short term and to what extent paying attention to the employment crisis in the short and medium term can have a (negative) impact on the Basque Country's smart specialisation strategy in the medium and long term.

The social field also faces great potential for the refocusing of activities and behaviours related to the sustainable transition process. This transcends the productive perspective and helps us to see how, for example, a policy aimed at sustainability that promotes teleworking simultaneously presents **the opportunity to redefine certain patterns among citizens such as those related to gender**, and thus contribute in different ways to the wellbeing of society. The current process may also change the value we place on different types of activities, promoting **a shift towards what is known as the foundational economy** (which prioritises above all health, education, housing, utilities and food).⁹

5.5 *Renewed and strengthened collaborative frameworks*

Finally, for positioning with respect to the trade-offs and transitions identified in the previous sections, and to manage them, there will be a strong need for renewed and strengthened collaboration between companies, governments, universities, other actors in the territory, and citizens. **Intermediary organisations**, such as cluster organisations or local development agencies, will have an even more critical role in this new scenario, both in connecting companies for the construction of new value chains or the refocusing of activities, and in generating intelligence on the needs of the business.¹⁰ Indeed, the strategic intelligence and connections that these intermediaries offer will be critical for effective collaborative processes between governments, universities, businesses and other actors in the territory.

The reconstruction and renewal stage requires processes that respond to the socioeconomic crisis within the framework of existing environmental challenges, and some companies will choose to develop strategies that link all these elements. In this context, concepts such as **the creation of shared value**, which aims to optimise value propositions of companies to meet their social needs while generating economic value for themselves, are likely to be useful.¹¹ Likewise, the framework of **open or collaborative innovation**, which encourages participatory communication around innovation in firms, empowering its suppliers, collaborators and clients for the identification of challenges associated to business operations and for the proposal of solutions.¹²

However, these approaches are still essentially individually-driven solutions to shared problems. This raises a question: if the results in the application of these theories are satisfactory on the individual-business level, could they be scaled up to give rise to interinstitutional organisational models in which Basque businesses develop collective value proposals that respond to the shared challenges of the territory and generate economic value for their organisations?

⁹See: Williams *et al.* (2019) and the manifesto 'After the pandemic' which has been written by a group of European researchers of the *foundational economy*: <https://foundationaleconomy.com/covid-19-report/>.

¹⁰On the roles of clusters, see: TCI Network (2017), Konstantynova and Wilson (2017) and Wilson (2019).

¹¹In view of the employment crisis that has been generated by limiting the movement of people and the economic activity of companies, it is likely that one of the main forms of shared value creation by companies in the near future will be the creation of jobs.

¹²See: Porter and Kramer (2011) and Lazarenko *et al.* (2017).

The answers that have been articulated globally to meet the challenge of COVID-19 in the short term have proved that this is possible.¹³ Also in the Basque Country, during the resistance stage, we are witnessing examples to prove this. Keeping in mind that there are many examples of initiatives that meet these characteristics, we will point out just a few.¹⁴ Thus, Ikusi has offered CISCO Webex with no charge for 90 days to facilitate teleworking; Pernod Ricard, has made its factories available to produce sanitising gel; groups such as "Resistencia Team" or "Makers" are achieving the collaboration of professionals, researchers, institutions and small businesses, through open source and 3D printing, to develop temporary alternatives to the mass production of health protection elements; and the Basque Government and SPRI are working with a number of cluster organisations to support collective purchasing efforts of materials and respirator manufacturing.

In this sense the socioeconomic threat posed by the current health crisis has been a type of 'open call' to promote collaborative strategies between different organisations pursuing the survival of the society and its firms. Organisations have developed transversal work teams to build innovative solutions to this shared problem. We can interpret this reaction as an example of implementation of the aforementioned theories scaled to the institutional level. Thus, the contingency of COVID-19 has shown that in response to the current and future socioeconomic crisis, **value propositions in collaborative platforms between different organisations can be constructed, which as well as addressing social and employment challenges, generate economic value for the territory and its firms.**

In this context, it is important to bear in mind that the crisis will accelerate the trend towards adopting technologies that facilitate automation and virtual interaction at work. According to *The Economist*, in the future there will be less face-to-face interaction and preference will be given to communication between key people within organisations.¹⁵ This tendency has very important implications for collaboration processes and for the competitiveness of territories because changing the way we communicate –doing so at a distance, mediated by screens– has a direct impact on how we learn and on innovation, which benefits from proximity. The literature on technology-mediated communication, responsible innovation and participatory communication proposes frameworks that can help to deepen and generate new knowledge that allows us to connect, scale and measure the micro processes of cooperation and learning that take place virtually for the benefit of innovation, competitiveness and welfare of the territories.

¹³ In the European context, the *European Cluster Alliance* has been very active in facilitating connections between cluster organisations and their companies, and the European Cluster Collaboration Platform has established an Industrial Clusters Response Portal (<https://www.clustercollaboration.eu/coronavirus>).

¹⁴ The newsletter of Confebask 'Empresa Vasca Creando Valor' contains a large selection of examples. See: <http://www.confebask.es/noticias-empresariales.html>.

¹⁵ The pandemic may exacerbate the divide among workers: www.economist.com/business/2020/04/11/the-pandemic-may-exacerbate-the-divide-among-workers.

6 GUIDELINES FOR ACTION AND STEPS TO FOLLOW

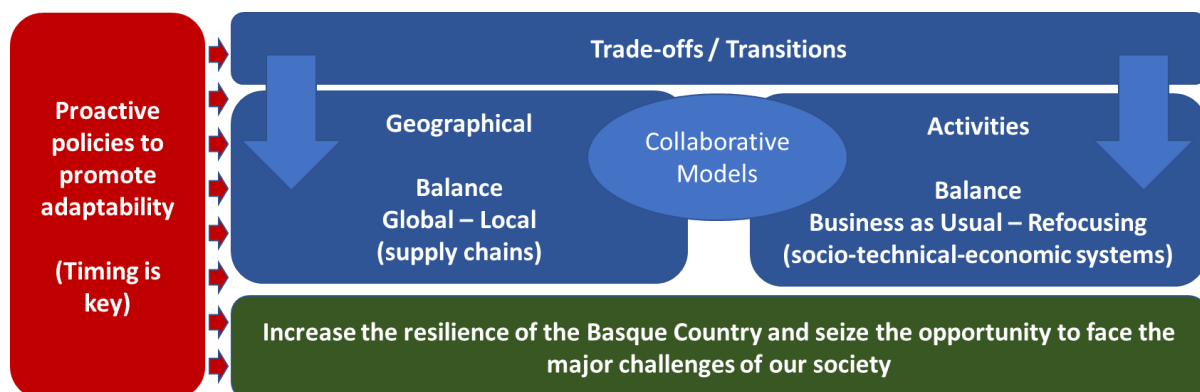
In a highly disruptive moment, when each actor is adapting its immediate actions and activities in the best possible way given circumstances, the aim of this document is to provide a first step in understanding the socioeconomic effects of COVID-19 in the Basque Country, in order to support Orkestra's various stakeholders in their reflections on possible actions for the future. Thus, we have identified two stages in the socioeconomic crisis generated by COVID-19:

- **Pandemic resistance** in which the economy and society as we knew them are "paused" and responses to the health crisis have been activated.
- **Reconstruction and renewal of the economy and society** that will gain momentum when the public health crisis is under control, but is also important to pre-empt during the resistance stage.

In relation to the resistance stage, the actions carried out so far have been presented and evaluated and it has been noted that, in the responses to the economic crisis, this is a stage where some of the measures can only be adopted by authorities at the national or European levels. However, the correct time for foundations to be laid for the future reconstruction and renewal of the economy and society is during this resistance stage, processes in which public administrations of the Basque Country have considerable leeway due to their policy competences.

Thus after analysing the policies that have been implemented during the resistance stage as well as microeconomic impacts anticipated in this first stage, we have started a reflection on the various elements that can determine the responses in the second reconstruction and renewal stage (see summary in Graph 4).

Graph 4 Summary of the conditioning factors of the reconstruction and renewal stage



Source: compiled by authors

Key recommendations for the current moment – immersed in resistance management, but without forgetting the need to lay the foundations for the reconstruction and renewal – have to do with capacity building and tools to properly understand each stage of the process and the specificities of the different sectors, value chains and business types. Only then can tailored policies be considered for each problem that may lead to an effective and efficient use of resources. Recommendations in this regard are:

1. Take care of the temporal dimension of actions
2. Develop intelligence on possible scenarios and their impacts:
 - Understand the financial vulnerability of different groups of companies in different scenarios
 - Understand the potential sectoral impacts in different scenarios
 - Identify the groups most affected by the crisis

3. Explicitly analyse the trade-offs between local and global, and between trying to recompose the previous *status quo* and have renewal strategies, with special emphasis on the need to face the employment crisis in the short term, to be able to implement strategies in the medium term with greater social stability
4. Integrate in the crisis response intermediate organisations (cluster organisations, local development agencies, chambers of commerce) to maximise the collaborative dimension of this response. Specifically, to contribute to:
 - Fostering connections to support the construction of new resilient value chains and/or the refocusing of activities in the context of new socio-technical-economic systems
 - Connecting businesses, especially SMEs, with other actors in the productive ecosystem so to have an accurate diagnosis of their situation and problems
5. Proactively identify possible scenarios for economic and social renewal which are desirable from the point of view of major societal challenges (climate emergency, the demographic transition and the digital revolution) and which could guide individual actions towards a shared strategy
6. Develop actions and policies for the medium-long term with high sensitivity to the desirable scenarios outlined above

The implementation of these recommendations is, undoubtedly, a complex challenge. In the context of a crisis characterised by its effects on such a large number of sectors, value chains and businesses, the solutions should be managed taking this complexity into account. This means that solutions will require, beyond a sum of individual reactions, a systemic response including coordination and the exploitation of synergies between actions to achieve the desired result for all actors in the Basque Country. It is, therefore, a time that requires the emergences of strong leaderships that, in turn, are relational and allow all actors in the territory to build collective responses to this collective challenge.

To contribute to this collective task Orkestra has set a challenge to deepen and extend analysis of the different elements that have been identified as key in the previous sections, as well as integrating new elements that territorial actors in the Basque Country consider relevant. This document is, therefore, the beginning of a process that the Institute will develop to accompany the economic and social actors in the Basque Country along the path of resistance, reconstruction and renewal in which we are all immersed.

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