

THE SCARS OF THE CRISIS: Spanish Landscapes After the Housing Bubble

A photo story by Luca Girardini - 2011

Article by Stefano Morandini and Luca Girardini * - 2012

"The scars of the crisis" was shot in 2011 in several suburban areas of the Madrid Region. It is a critical testimony to a real estate industry run amok, describing in pictures the impact the housing bubble in Spain had on both the land and society. The endless rows of unfinished buildings are emblematic of the grandiose failure of one of the most disastrous real estate speculations in decades: brand-new ghost towns most likely to remain uninhabited as they grow old.

Travelling around Spain one can easily spot entire neighborhoods of cookie-cutter construction, incomplete roads, and enormous residential and commercial buildings. In these basically empty towns, a handful of residents live in isolation far from any community services. This phenomenon is not confined to large urban areas but also extends into the countryside: once the real estate opportunities in the big cities were exhausted, speculation then began focusing on smaller town and rural areas. Often the mere presence of a provincial or national highway was excuse enough to start large-scale urban planning, irrespective of the absence of basic minimum services or an organic urban structure. To illustrate the scope of the situation, some say that the supply of homes in Spain may be sufficient to meet demand for the next twenty years.

The environmental impact of the housing bubble is terribly evident. For many years in Spain the number of new buildings has been superior to France, Germany and Italy combined. Today there are about 1.5 million unfinished homes and 600,000 to one million unsold. Many are likely to be repossessed soon, as people find it impossible to pay their mortgages in this country where the unemployment rate hovers around 20 percent.

Standing before so many skeletons of incomplete homes and deserted neighborhoods, one is forced to stop, reflect and ask "What happened?" What at a first glance seems like little more than collective madness -real estate madness, banking madness, family madness- may appear less mad if seen from a different point of view. So, what happened in Spain?

Moving beyond the notions of efficient markets and rational agents, recent studies and theories propose interesting explanations of how the housing bubble boomed and burst. The American economist Robert Shiller, an expert in behavioral finance, carried out several experiments showing how markets can be subject to something called "irrational exuberance." According to this theory, economic agents tend to be overly optimistic during periods of economic boom and overly pessimistic in periods of crisis. This kind of behavior contributes to the creation of speculative bubbles and exacerbates the consequences when the bubble bursts.

The dot-com stock market bubble of 2000 is a textbook example of how euphoria infected financial markets, sending stock prices soaring until the inevitable collapse. Many financial analysts believe that the euphoria surrounding the listing of internet giants such as Facebook, LinkedIn, Zynga and others may be the next dot-com bubble.

During the Spanish economic boom, two measures strongly contributed to the creation of the housing bubble: the Land Act of 1998 and the labor market reform of 2002. The Land Act made it easier for local public authorities to sell land to private entities. The main goal was to create incentive for real estate investments, which in turn would spur economic growth and make homes more affordable. The labor reform increased flexibility in the job market, helping many people, especially the young, find employment in the construction sector.

As everyone seemed to be able to find a job, the traditionally high rate of unemployment plunged. As optimism about economic prospects spread among the population, obtaining a mortgage became incredibly easy. Fed by the surging demand, housing prices exploded from €1,090/m² in 1998 to €2,900/m² in 2007. However, the growth in the average wage did not go down the same path, instead remaining among the lowest in the European Community.

The Spanish euphoria became another textbook example of the speculative bubble: everyone became willing to buy a certain good -in this case, a house- priced much higher than its true value, believing that it could later be sold at a higher price. One of the most common misconceptions among savers and investors, and not just in Spain, is that real estate is always a safe investment. It was often said that housing prices would always go up, and if things didn't go well, you could sell. Spaniards discovered on their own that reality is a little bit different.

The financial crisis that exploded on Wall Street in 2008 quickly infected European financial markets and is far from over, as shown by the European sovereign debt crisis.

Spanish savings banks, stuck between construction firms on one side and mortgage holders on the other, were hit especially hard by the shortage of liquidity. When the bubble burst/crisis hit, many firms defaulted and people lost their jobs and thus the ability to repay their mortgages. Combined with the simultaneous crisis of European and American banks, the liquidity crisis then became an insolvency crisis. In the midst of this downward spiral, the fragility of the Spanish economic boom was unveiled.

Ironically, many companies have been going ahead with construction projects as if nothing ever happened. The Spanish economy, after lounging for so long in the shade of the real estate boom, today struggles to find sources of growth outside construction. As a way to ease the immediate impact of the crisis on families and the hemorrhaging job market, the government is continuing to put money into new buildings and infrastructures.

These many empty buildings -the scars of the crisis- have defaced the Spanish countryside, but the real wounds in the Spanish economic system are the lost jobs and the gargantuan debts burdening families. It is difficult to tell whether families were fooled by irresponsible banks, or instead the whole system was victim of one big collective hallucination. But today the challenge for Spanish institutions is to focus on resuming economic growth and stimulate the development of other sectors and new activities.