Austerity Policy in Europe: Spain

To date, the austerity policy initiated by the Socialist Party in May 2010 and intensified since the beginning of 2012 under Rajoy’s conservative government has concentrated on spending cuts in the public sector with clear negative effects for public employees. Up to now the social security system has been less affected.

The structural reform of the labour market has strengthened the position of employers, made redundancies easier and weakened the negotiating power of the trade unions.

A further contraction of the Spanish economy is expected in 2012 and 2013. Unemployment will remain at the very high level of 25 percent, social inequality will increase, and progress in the restructuring of public finances will be slow.

The political situation will remain stable for the time being. The conservative Partido Popular dominates political events and there are no elections scheduled for the next three years. The growing dissatisfaction requires a socio-political player capable of channelling the isolated protest actions.
For months, headlines on the Spanish crisis have been a recurring element in the German and European media landscape. The palette ranges from the difficulties of the Spanish banks and the extremely high rate of unemployment, through to the austerity policy of Rajoy’s government and its possible consequences for social peace. As a rule, these reports are garnished with speculations on the dangers facing the euro zone and the European integration process as a result of the Spanish situation.

From a Spanish perspective the themes are similar, however the line of sight is a different one. Here the question tends to be: what threat does Europe pose to Spain, how does the «European recipe» affect the country. The government and loyal media have already delivered the headlines: Spain has done its homework; now it is up to Europe to finally fulfil its commitments.

For a long time Europe served as a beacon of light for Spain. At the beginning of the 20th century the Spanish philosopher Ortega y Gasset postulated: «If Spain is the problem, then Europe is the solution.» However, for many Spaniards Europe is now no longer the solution but the problem. For many the promise has now become a threat, a threat to all that Spanish society has achieved over the last three decades. Soon it may not just be isolated individuals that have the idea of reversing the quote and proposing «the real Spain» as the solution. Alas, Europe …

Political framework: the dominance of the conservative Partido Popular

Following the PSOE’s (Partido Socialista Obrero Español/PSOE Spanish Socialist Workers’ Party) term of office from 2004-2011, the conservative People’s Party (Partido Popular/PP) under Prime Minister Mariano Rajoy swept the board in 2011. The party enjoys a comfortable absolute majority in the national parliament, while the PSOE has fallen to a historical low. The PP is also currently in charge in the majority of the regions. Furthermore, it also governs in three of the four largest cities (Madrid, Valencia; Seville). The PSOE only heads the governments in Andalusia and Asturias, in each case supported by the leftwing Izquierda Unida, as well as in the Basque country (in a minority government half-heartedly supported by the PP). In Catalonia as well as on the Canary Islands regional parties are in office (Convergencia i Unió, CiU, Coalición Canaria respectively).

Economic framework: built on sand for too long

In the decade before the outbreak of the crisis Spain appeared to be well on the road to closing the prosperity gap separating it from Europe’s most advanced economies. Growth rates significantly exceeded the EU average, employment increased rapidly, the national budget displayed vigorous surpluses between 2005 and 2007, the relationship between gross public debt and gross domestic product (GDP) appeared friendlier from year to year. In 2006 pro capita income reached the level of Italy, falling just short of the level of France. This picture began to change in 2009 – dramatically. National income declined (and still continues to), unemployment quickly reached a level of 20 percent (and continues to climb), the budget deficit amounted to over ten percent (and is currently only marginally lower) and national debt increased significantly.1

What happened? Precisely that which a number of observers had noted years before, without it having effected a rigorous change in policy: the house of cards of the Spanish real estate boom, in the truest sense of the word built on sand, collapsed in on itself. And as the Spanish economic boom was primarily built on this hypertrophic building sector – which every year since 2004 contributed over ten percent to Spain’s gross value added, employing more than 2.7 million people at peak times – the entire economy has been affected. This also extended to the state, with a high percentage of its revenue during the years of the real estate boom coming from taxes on real estate transactions.

There is a whole series of internationally competitive Spanish companies, beginning with Banco Santander and Telefónica, through to the clothing company Inditex (Zara), whose owner has just displaced Warren Buffet as the third richest man on earth. However, the success of

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1. On this subject see the overview of selected data on economic development in the appendix. In order to provide a reliable comparison with other countries this paper only employs national data for the years up to and including 2011 from Eurostat (unless otherwise indicated). For the regional level and for 2012 national sources have also been consulted.
these companies now has little to do with the Spanish economy. They are internationally positioned companies whose profit is generated, to a considerable degree, in markets outside of Spain. Overall, the Spanish economy is characterised by small and medium sized businesses in more or less traditional industry sectors with little capital of their own who are dependent on credit financing. These companies, which as a rule lack efficiency and innovative production methods, are primarily geared towards the Spanish market. When this market collapses – because one of the most important industries in respect of employment and domestic demand is heading for a crisis of over-accumulation of its own making, and, simultaneously, the international financial crisis is bringing about a credit squeeze for the entire economy – then illusions will quickly be dispelled.

May 2010 to July 2012: a brief history of the austerity policy

The austerity and reform policies introduced in May 2010, and subsequently tightened at ever shorter intervals, are designed, on the one hand, to contribute to a consolidation of public finances, on the other, to assist in overcoming the structural problems of Spain’s economy. The PSOE government carried out the first step in May 2010 with an austerity package which envisaged approx. 15 billion Euros worth of cuts. Wages in the public sector were cut by an average of five percent and frozen for 2011. Public investment for 2010 and 2011 was reduced by more than six billion Euros. As former flagship projects of the PSOE government, the withdrawal of the »baby premium« of 2,500 Euros which had been introduced shortly before, and the cuts in development aid (600 million Euros), were of great symbolic importance. In Autumn 2010 the government followed up with its first reform of the labour market. This was primarily designed to reduce financial incentives for the hiring of employees on temporary contracts, and instead, promote the signing of permanent contracts. However, only one year later, in light of the continued growth in unemployment, the government once again relaxed the legislation for temporary contracts. This labour market reform – which in retrospect appears to lack coherency – was followed by a reform of the pension system at the start of 2011. This envisaged a gradual raising of the retirement age from 65 to 67 (transitional period from 2015 to 2027) and a significant extension of the contribution years considered when calculating the pension (from 15 to 25 years with a transitional period from 2013 to 2022).

Within the first week of its term in office, the PP government, which had been in power since Christmas 2011, placed a package of immediate measures on the table designed to generate a total of ca. 15 billion Euros of revenue for the treasury. Nine billion would be composed of cuts and six billion of additional revenue. The cuts went across-the-board, affecting the majority of ministries, state owned companies (railway, television) as well as parties and social partners whose subsidies were reduced by 20 percent. The wages of public sector workers were frozen, the working week was extended from 35 to 37.5 hours. Income tax rates rose by between 0.75 and seven percent, with greater percentage increases in the higher income groups. Capital gains taxes also rose by between two and six percent. Theoretically these measures were designed to hit the higher-income earners – however in practice only 0.1 percent of all tax payers declare an income which would be subject to the seven percent increase.

If these immediate measures were relatively balanced, then the labour market reforms presented in February 2012 – even in the opinion of the government – deserved the title »radical«. The reform significantly strengthened the negotiation and decision making power of the employers. These were now in a position to change working conditions and working hours without much ado, and even cut wages, as long as this was in the interest of raising productivity and sales figures had fallen for two quarters. A fall in turnover over nine consecutive months are already sufficient reason for a fair dismissal. At the same time compensation payments for unfair dismissals were reduced by almost 30 percent. Furthermore, company agreements between employers and employees now took precedent over agreements at regional or industry level.

With the 2012 budget approved by parliament in the middle of April the PP finally had to show its colours. The government had originally intended to present a budget with a deficit of 5.8 percent of GDP, however, in negotiations with the European Commission it only succeeded in relaxing the deficit originally agreed for 2012 from 4.4 to 5.3 percent. Compared to the previous year this budget meant a reduction in expenditure of over 13 billion Euros or ca. 17 percent. The cut in the Foreign Ministry’s
The austerity policy is dominated by cuts in expenditure which are increasingly hitting public sector employees (catchword »wage reductions«), accompanied by increased demands (catchword »increase in working hours«), while the revenue side (catchword »tax increases«) has played a lesser role up to now.

To date, social security programmes have been little affected; nevertheless, the first cuts in monetary benefits for recipients of unemployment insurance as well as a tightening of eligibility for health and pension insurance, i.e. benefit entitlements, have already occurred or are in discussion.

The structural reform of the labour market is clearly designed to strengthen the position of employers with respect to employees by facilitating internal flexibility (unilateral adjustment of working conditions and wages), their external variants (cost reduction through redundancies, administrative and legal relaxation) as well as through changed rules for wage negotiations (precedence of company over comprehensive agreements).

How is the austerity policy justified?

At the time of the outbreak of the financial crisis the then head of government Zapatero took some time before he even reacted to the crisis. He initially denied its...
existence, and then over the course of following months provided assurances that its resolution would not be at the expense of the weaker. He aimed to achieve this through an expansive budgetary policy, whereupon the budget deficit for 2010 rose to over eleven percent. However, in May 2010 Zapatero instituted a dramatic turnaround to an austerity policy. This was justified with the necessity of calming »the markets« and meeting the EU’s expectations.

In contrast, the new PP government found it easier to explain its case, taking the helm in the middle of the crisis as it did. And in terms of ideology the austerity policy is also more in tune with its agenda. That this policy was not explicitly mentioned in its election programme did not prove a hurdle: as is usual in politics, it was argued following the election victory that one could not predict that the previous government would leave behind a legacy that would prove so difficult to manage. However, the PP did sketch the broad outlines of its policy in the election programme: government austerity policy with simultaneous liberalisation of the economy, privatisation of the social state, strengthening of the centre with respect to the regions, and the preservation of traditional values and institutions – (neo)classical conservative positions which do justice to the party’s brand core. It was only tax increases that were nowhere to be found in the over 200 page programme.

However, the PP also expected »the markets« to reward the PP’s election victory in and of itself. After this failed to materialise the government initially hoped the structural reforms undertaken would calm »the markets« and the duo of Merkel and Sarkozy. However, this positive effect also failed to materialise as hoped. Since then the government of Rajoy has also presented the austerity policy as largely a compulsory programme imposed from outside. The coming months will show to what extent this line of reasoning will be maintained or whether ideological arguments will be fielded more offensively again. Irrespective of the current status of public finances, there is little doubt that the PP government intends to further restrict the role of the state in the economy, health and education sectors.

Which social groups are behind this policy?

It was the »gentle« pressure of circumstances – in particular the double-digit budget deficit and a growing risk premium, together with signals from the European institutions and countries – that led Prime Minister Zapatero to take the road of austerity in May 2010. For months prior to this he had rejected such a policy and just days before had described it as detrimental to the country’s growth prospects. There was neither a majority in his party nor amongst its supporters for such austerity measures.

Initially, the PP also criticised the austerity policy and generally opposed the PSOE’s proposed measures in parliament. It was only in the second half of 2011 as elections were approaching and the PP suspected that the precarious budgetary situation would continue that it changed its course. In September 2011 it voted to include a debt brake in the Spanish constitution. Since taking office the party has increasingly had the courage of its convictions and presented austerity policy and structural reform as the only alternative. However, at the same time it has (successfully) worked to gain time for the implementation of this policy and delay somewhat the agreed deficit reduction.

The PSOE and the other parties represented in parliament reject the government’s current policy. However the PSOE makes it clear that it supports the PP’s efforts to avoid an EU intervention and the resulting conditions. The Catalonian regional party CiU has denied the PP its parliamentary support, however in Catalonia it is pursuing a harsh austerity policy. The only region which is genuinely attempting to develop alternatives to an austerity policy, despite a difficult budgetary situation, is Andalusia where the PSOE governs together with the Izquierda Unida. In contrast in the Basque country, where the PSOE is also in power, the austerity policy is hardly a theme due to positive exceptional circumstances (relatively good economic data, low unemployment, high regional tax revenue, moderate level of debt).

Outside the sphere of government and parliament it is the trade unions in particular who have expressed their disapproval of the austerity policy and structural reforms (labour market, pension system). In addition to the
umbrella organisations Unión General de Trabajadores (UGT) and Confederación Sindical de Comisiones Obreras (CC.OO.) it is above all the public sector and education unions who have mobilised against government policy. In contrast, the employer side is largely in agreement with the PP’s reform course. The media landscape is highly politicised and opinions are polarised accordingly. However, there is general agreement that both parties have left much to be desired in the implementation and explanation of their policies and that there is a lack of certainty and transparency.

A special theme is the question of foreign players. As long as the PSOE was in office it was clear that the austerity policy was developed and implemented against its actual convictions and under pressure from outside. However, in contrast, the PP government has long emphasised that it has the situation under control and that no one could or would exert pressure on it – a position which culminated in the statement from Prime Minister Rajoy that it was not the EU or Angela Merkel that had exerted pressure on him prior to his request for support from the European partners in solving the banking crisis, but that the pressure had came from himself. However, in order to minimise the political costs of the austerity policy even the PP has now adopted the position that it represents a reaction to external pressure.

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In 2011, with a gross public debt of 68.5 percent of GDP, Spain maintained its position as one of western Europe’s best performers in respect of national debt, with a wide gap between it and the other southern European crisis states. In Spain total state expenditure is 43.6 percent of GDP, at the bottom end in a comparison of the EU-15. However, national debt is expected to rise to ca. 80 percent of GDP by the end of 2012. Furthermore, these figures do not factor in the financial costs which could result from the rescue of the banks.

In the meantime, the Spanish economy has continued its slow decline, without the prospect of improvement in the next year and a half. After gross domestic product displayed slight growth following an initial drop in the first and second quarters of 2011, it has now returned to its downward trend. A decline of 1.5 to two percent is expected for 2012, and in 2013 is likely to continue to shrink (slightly). The investment quota which stood at between 26.3 and 30.7 percent of GDP between 2002 and 2008 only reached a level of 21.7 percent in 2011. It is also expected to be less than 22 percent in 2012. Only exports have shown a positive development.

Employment has declined (in absolute figures) every year since 2007 from 20.7 million to 18.4 million people in 2011. In June 2012 unemployment reached a record level of 24.8 percent (seasonally adjusted). For the age range 15 to 25 the figure was 52.7 percent. At the end of 2011 the employment rate was 57.7 percent – in 2007 it reached its peak level of 65.6 percent (age range 15-64). In light of poor growth prospects and the easing of restrictions on redundancies as a result of the labour market reforms it is to be expected that there will be further reductions in the workforce. A rate of unem-
ployment of 25 percent is in sight, a growth in absolute numbers to six million unemployed cannot be excluded. Income distribution has deteriorated parallel to the growth in unemployment. The Gini index which stood at ca. 31.3 in the period between 2006-2008 rose to 33.9 by 2010, the highest level in western Europe (comparable data for 2011 is not yet available). The development of the income quintile ratio (S80/S20) is similar. In 2010 a figure of 6.9 was recorded, following 6.0 in 2009 and 5.4 in the period between 2006-2008. Since then social inequality is likely to have increased. According to provisional data from the National Statistical Institute, the percentage of people with an income of less than 60 percent of the average (median) income has risen from 19.5 percent in 2009 to 20.7 percent in 2010 and 21.8 percent in 2011.

If one takes into account that pro capita income has fallen significantly since 2006, it is apparent that, with increasing inequality, absolute as well as relative poverty is on the rise. For example, up until the middle of 2012 only just over 65 percent of the unemployed received unemployment benefit, in 2009 it was 76 percent. In an increasing number of Spanish households there is no longer anyone who receives any form of income at all, whether it be a wage or transfer income. These households are dependent on charity.

So much for the sober facts, which lead to the conclusion that Spain has at least two years of hardship in front of it. But what are the prospects for a rapid recovery? Opinions are divided. A number of commentators point to the successful companies already mentioned, to the ray of hope of rising exports – which however are starting from a relatively low level – and to the fact that unit labour costs have fallen as well as the rise in industrial productivity and the improvement in Spain’s competitiveness vis-à-vis other European countries.

The counter argument states that the austerity policy does not just inhibit growth and intensify the social climate in the short and medium term. Instead, the cuts in future investments in the areas of responsibility of the ministries for infrastructure, industry and energy will impede the necessary transition to a new, qualitatively improved production model. As a consequence, Spain, in the long term, will also be forced to face up to international competition in segments in which social and ecological dumping are common practice. The prospect of catching up with Europe’s more advanced economies would definitively recede into the distant future, and in the best case, Spain would merely succeed in keeping pace with the leading group in the Mediterranean League.

Political consequences: relative peace for the time being

As the financial crisis erupted in the autumn of 2008 the PSOE under Prime Minister Zapatero had just begun its second term in office. After three years of crisis management, which was convincing neither in terms of concept nor communication, the PSOE was doubly punished in 2011: first in the countrywide local government elections and regional elections taking place, virtually nationwide, at the same time on May 22, and then again in the national parliamentary elections (brought forward several months) on November 20. Almost everywhere the PSOE fell to a historic low. Nationally it fell from 43.9 percent to 28.7 percent, while the PP achieved 44.7 percent of the votes, sufficient for a comfortable absolute majority in the allocation of seats.

However, this absolute majority was not a sign of the PP’s strength but the weakness of the PSOE which had lost nearly 40 percent of its voters compared to the previous parliamentary election. If elections were to be held in the summer of 2012 the PP would fall victim to a similar development. According to current opinion polls only seven months after taking office the PP would lose at least eight percent of its vote compared to the election results from November 2011. However, it would not be the PSOE that would profit from this but the smaller parties, above all the left wing Izquierda Unida and the liberal UPyD.

In light of the widespread dissatisfaction with the political parties – in opinion polls on the standing of the country’s most important institutions the political parties now occupy last place, less than ten percent of those polled trust them – it would not be surprising if right wing populist parties or movements succeeded in using this trend to their own advantage. That there is a potential for such parties can be seen in the fact that approximately one tenth of PP voters categorise themselves as extreme right wing. However, up to now, the extreme right has led a niche existence, split into a plethora of small and miniscule parties.
Of greater relevance is the cross-party, i.e. extra-parliamentary democracy movement of the Indignados who gained attention in May 2011 beyond Spain’s borders as they mobilised both “against the crisis” and against the established political system. It no longer has the same presence in the public sphere as at the time of its sudden appearance last year, however it continues to be active at the local level. At present one can observe the formation of a new alliance, the so called Social Summit, Cumbre Social. Over a thousand organisations now make up the alliance, including the trade unions who were not welcomed as part of last year’s May 15 movement. It is possible that this will develop into a platform capable of channelling the widespread dissatisfaction and uniting the power of the traditional organisations and newly formed movements.

However, at present, the PP’s hegemonic position does not appear to be seriously threatened. There are no elections of importance for the PP’s maintenance of power scheduled before the middle of 2015, so that the dominance of one party, so unique in the annals of Spanish democracy, is likely to continue for years. The PP sees the clear election victory as confirmation that Spain’s citizens sought to clarify relations under conditions of crisis, interpreting this election victory as an ex ante vote for its current policies. Isolated demands of the opposition parties or other social groups that the PP government must legitimise its policy through referendums go largely unheard.

Thus, for the coming months, the interested public will continue to assemble in front of the TV screens each Friday lunchtime to hear the statements of the Deputy Prime Minister Soraya Sáenz de Santamaría as she announces the latest cabinet decisions. The next time will be on August 24. Then the matter in hand will be the institution of measures which will enable the country to meet its obligations under the Memorandum of Understanding specifying the conditions for the granting of up to 100 billion Euros in aid to the banks from the rescue fund EFSF (European Financial Stability Facility).

And in September, when the Spaniards return from their summer holidays, the country can look forward to an unusually hot autumn.
Overview of economic data: Spain 2000 - 2011

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<td>Change compared to previous year (%)</td>
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<td>18.0</td>
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<td>1.9</td>
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<td><strong>Gross public debt</strong> Percentage of GDP</td>
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<td><strong>Income quintile ratio</strong> ($80/$20)</td>
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Source: epp.eurostat.ec.europa.eu
Friedrich Ebert Foundation will publish in the coming weeks a loose series of papers on the economic and fiscal policies pursued by various European governments in the wake of the financial and Euro zone crisis.

Recently have been published:

**Austeritätspolitik in Europa: Spanien**
by Lothar Witte, FES Internationale Politikanalyse, August 2012

**Austerity Policies in Europe: The Case of Poland**
by Gavien Rae, FES International Policy Analysis, August 2012

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