STUDY

Social Cohesion and the State in Times of Austerity

Country Case Study: Spain

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- The recent evolution of the Spanish economy has been strongly affected by the austerity policies recommended by the European Commission. The core of this strategy has focused on reducing the deficit and public debt.

- The economic crisis has had a devastating impact on employment. In five years, the unemployment rate has risen 17.5 percentage points (from 9.6 per cent to 27.2 per cent, the highest in history). High unemployment has become the major imbalance of the Spanish economy and the main source of social problems.

- In the fight against this situation, the Spanish government has opted for internal devaluation, depressing real wages. The aim is to gain competitiveness, increase exports and thereby increase employment.

- This strategy has had tremendous adverse consequences for social expenditure. At constant prices, public spending on health care, education and unemployment has declined in the second part of the crisis (since 2010).

- The combination of internal devaluation and falling social expenditure has had adverse effects on social cohesion. Disposable income has decreased, poverty and income inequality have risen dramatically and the number of households in economic difficulties has increased. This is affecting the most vulnerable in particular and has created a more fragmented society.

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Content

1. Introduction

The origins of the economic and financial crisis are usually placed at the end of 2007 or early 2008, depending on which socio-economic indicators are taken as reference. According to the type of fiscal policy and the structural reform agenda laid down by subsequent governments to address the impact of and attempt to overcome the economic downturn, we can identify various phases during the already five-year-long crisis that is hitting the Spanish economy.

The first phase runs from the start to the first quarter of 2010, when a range of demand-driven policies were applied: first, expansionary measures to try to curb the effect of the crisis and to induce sustained activity; and second, policy measures to strengthen social protection, mainly by alleviating the effects of rising unemployment.

Although the Socialist government acquired moderate expansionary momentum with its economic policy, its fiscal stance turned procyclical and contractionary from May 2010, when the government abruptly switched policies and adopted an agenda imposed by the European Commission, with restrictive reforms and against the guidelines the government had previously adhered to. These measures meant that the Socialist government was in practice crossing a number of red lines of its traditional ideology, affecting areas particularly sensitive for its potential electorate, mainly civil servant wage cuts and pension freezes, and the implementation of an economic policy grounded in unambiguously neoliberal principles. Therefore May 2010 can be taken as a reference for the commencement of fiscal austerity. The culmination of this stage, which symbolically signals this programmatic shift on the part of the Socialist government, was the overnight reform of the Spanish Constitution in September 2011. It took place without parliamentary debate in order to include strict fiscal rules limiting the deficit and public debt (it was developed afterwards through Organic Law 2/2012 of 27 April on Budgetary Stability and Financial Sustainability).

The third period starts when the conservative Popular Party came into office, after its landslide victory in the general elections of November 2011 and extends to the present. From the outset, the Popular Party government implemented a series of budget cuts in virtually all areas and it has raised most taxes. The government has also undertaken fundamental reforms in key institutions, such as the labour market, the financial sector and the public administration, beyond the objectives of economic adjustment and with the intention of structurally changing Spain's socioeconomic model, with substantial implications for democratic institutions and citizens.

The aim of this report is to analyse the consequences of the policies developed since May 2010, and to observe their short-term effects on the main variables of the Spanish economy and medium-term implications for future development.

2. General Economic Development

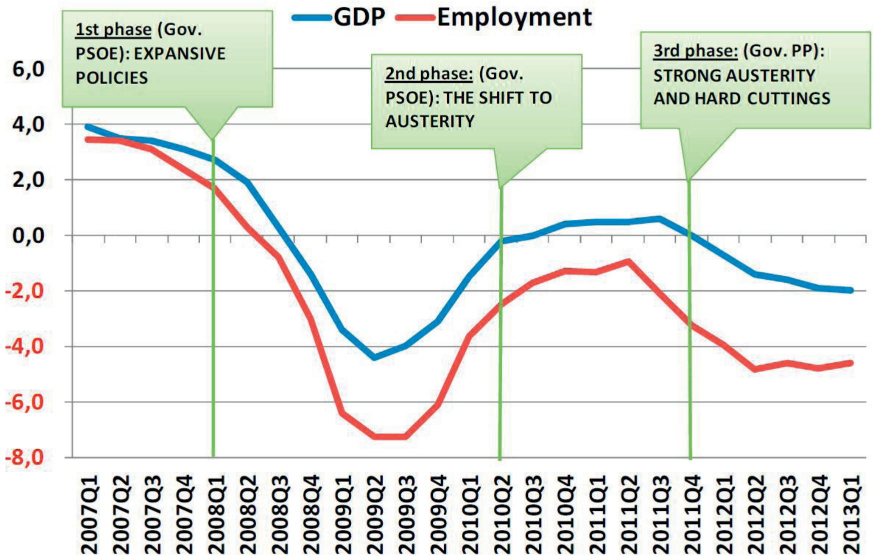
2.1 Economic Growth versus Austerity and Return to Recession

First, it is interesting to note how of economic activity and employment have evolved during the crisis, following the three-step approach to the crisis mentioned above. This allows us to see the drastic turn towards austerity undertaken by the Socialist government led by Jose Luis Rodriguez Zapatero, and how this change took effect when GDP and employment figures were on a path of strong recovery after two years of steady decline. In fact, the implementation of the new fiscal consolidation agenda coincided with a U-turn by both variables. A year later, when the worsening sovereign debt crisis and the tail risks affecting confidence in the euro itself had started to recede, Spain entered into a second recession with the third phase of the crisis (intensification of austerity with Mariano Rajoy's Popular Party government).

It is necessary, however, to put these developments in the context of the euro area because the austerity agenda was designed and promoted at the European level, following the meeting of Ecofin (Economic Ministers) of 9 May 2010, in the wake of the Greek crisis.

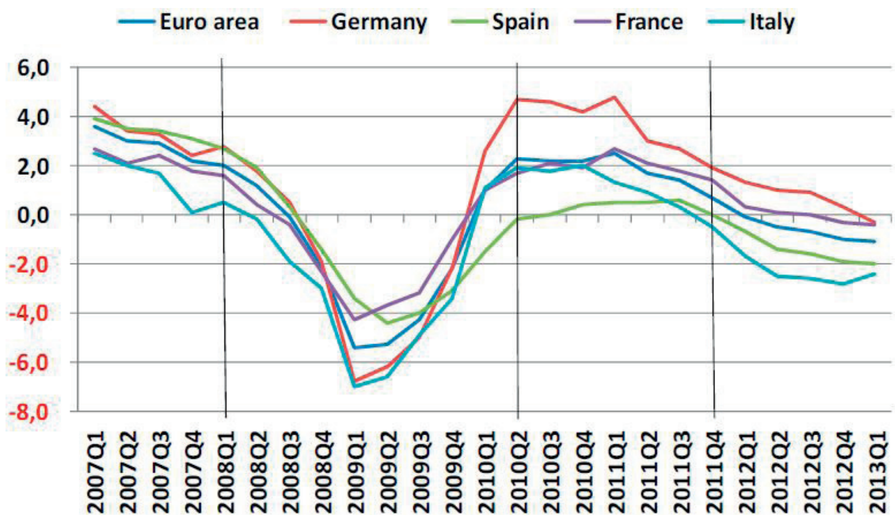
The evolution of economic activity in the euro area and in particular in its four most important countries shows, first, the great similarity of the trend in all of them, indicating a common pattern of behaviour; and second, that although the first recession in Spain was less intense (as in France), also the recovery in 2009 was slower, and while other countries grew close to 2 per cent annually (Germany by more than 4 per cent) Spain continued to

Figure 1: Activity and employment during the crisis: policies implemented



Source: Authors' elaboration from data compiled from Quarterly National Accounts (CNTR) and National Labour Force Survey (EPA). National Institute of Statistics (INE).

Figure 2: Activity in the euro zone

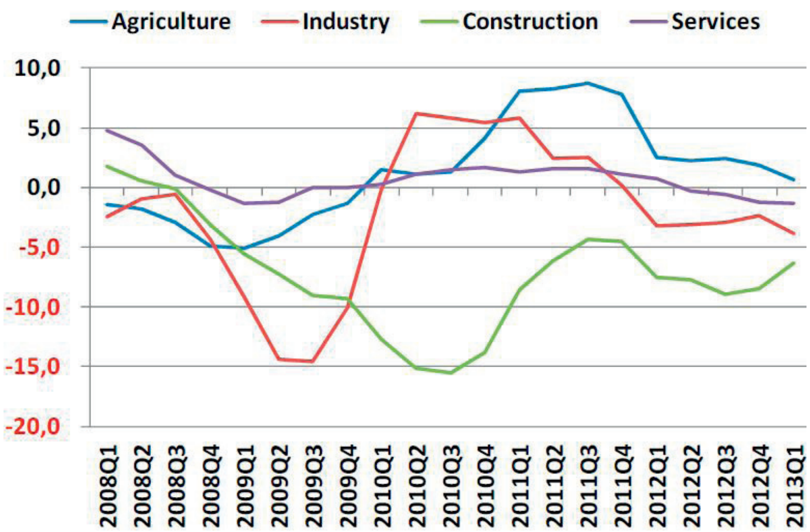


Source: Eurostat.

have negative rates. This is important because it explains why the coordinated policy changes, with the withdrawal of stimulus and spending cuts, hurt Spain in particular and prevented the consolidation of its nascent recovery, leading it into recession again in 2012. Here is why we can talk about a self-inflicted second recession.

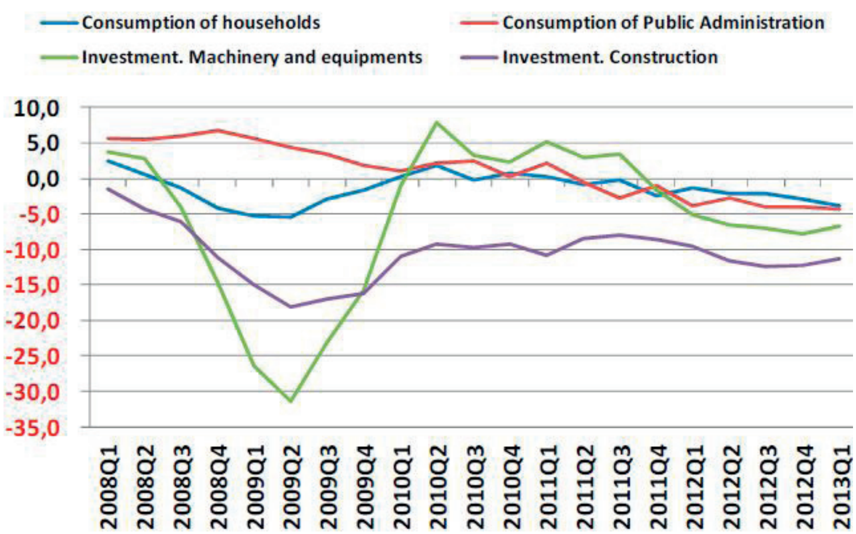
From a sectoral perspective, real estate has from the first been at the core of the crisis, following the bursting of the speculative bubble. It has remained in a recessionary situation since mid-2008. The primary sector maintained positive rates from late 2009, although there has been a continuous decline since late 2011. Industry is the sector that has suffered most clearly from austerity policies since

Figure 3: Activity by sectors (GVA)



Source: Quarterly National Accounts (INE).

Figure 4: Domestic demand (major components)

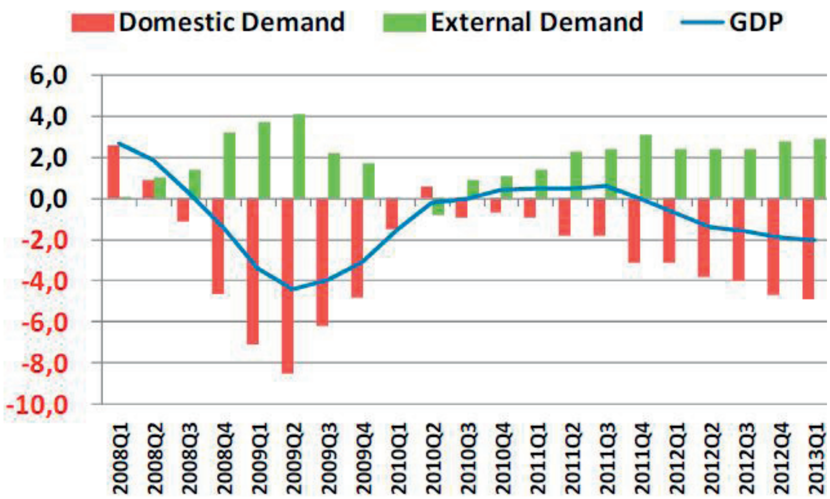


Source: Quarterly National Accounts (INE).

the second quarter of 2010. When it seemed to have overcome the initial impact of the crisis, posting growth above 5 per cent, it started to experience a sizeable loss of momentum and settled back in negative figures from the fourth quarter of 2011. Finally, the service sector has withstood the crisis best overall. Accounting for two-thirds of total production, it has allowed Spain to record a moderate overall decline in GDP, lower than many of its European partners. Since the third quarter of 2011 it has seen a slow decline, entering into negative rates a year ago, and with a tendency to intensify.

The conclusion is that since the third quarter of 2011 there has been a general worsening of the four main sectors, three of them already in recession, and the other (agriculture) is about to enter into negative growth rates.

Figure 5: Contribution of domestic and external demand to growth



Source: Quarterly National Accounts (INE).

On the demand side, the main macroeconomic aggregates reflect, perhaps even more clearly, the impact of the contractionary policies. Overall, the second quarter of 2010 marked a turning point for the main demand variables. Then, the household consumption slowed its recovery and began on a downward path that eventually led into negative numbers in 2011. In 2012 private consumption deteriorated even further. Intense wage devaluation since the beginning of 2012, linked to large cumulative job losses, has a lot to do with this development of household spending. On the other hand, government spending has been moderating since 2009, but in 2011 it began to fall, intensifying the situation.

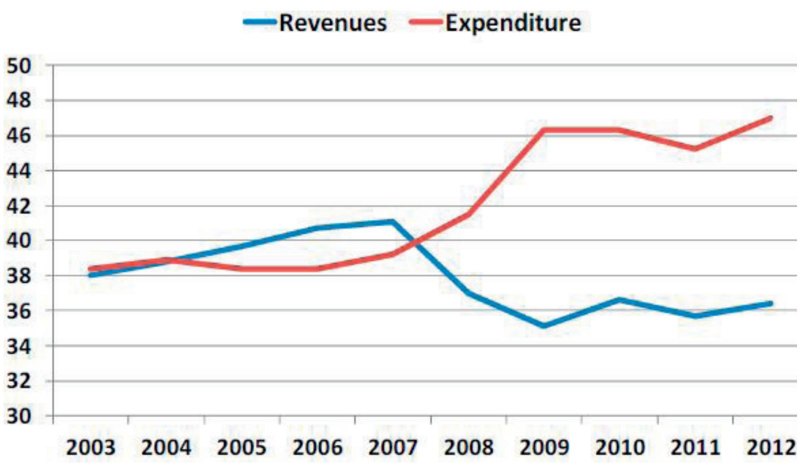
Investment does not offer a much better picture. In the third quarter of 2010 machinery and equipment, which are essential for industrial activity, abruptly interrupted the upward trend they had enjoyed since mid-2009. Investment first began to moderate its growth rate, and from early 2012, it increasingly shrank. Construction investment has been collapsing since the beginning of the crisis and it has not shown any symptoms of potential recovery.

One of the main consequences of the wage devaluation strategy has been the severe weakness of domestic demand, in effect imposing an export-led GDP growth as the only way forward. The second quarter of 2010 is again a reference for understanding the development of exports and imports. At that time both macro variables were taking off, only to start to decline again: imports declined due to the effect of the new policy on consumer income and uncertainty about future developments, which increased the preference for saving. Exports declined because of similar policies in the euro area, the main destination of Spanish exports.

The positive contribution to growth of the external sector since 2010 is due to imports, which fell further (in fact, from mid-2011), while exports grew very moderately. The result is an external demand adding nearly 3 percentage points to growth and maintaining a positive contribution for two years, but by contrast the contribution of domestic demand has continued to worsen since late 2010 and has taken almost 5 percentage points from GDP growth.

Neither the Spanish structure of production (with a small and low value-added industry and high importance of tourism) nor the economic situation of the euro area (which was also entering a recession) suggests that the foreign sector can become a component of Spanish take-off. So far, the data show that the adjustment policies and wage cuts are hurting consumption and investment rather than favouring the capacity to compete at global level, a balance that is unfavourable for growth. Without a recovery in domestic demand, a sustained recovery of the Spanish economy seems unlikely.

Figure 6: Public revenues and expenditure, 2003–2012 (% GDP)



Source: Eurostat.

2.2 Sustainability of Public Finances

The need to reduce the deficit and public debt are the main objectives that have underpinned austerity policies across Europe, and notably in Spain since May 2010. The economic crisis meant a sharp increase in public spending due basically to the operation of the automatic stabilizer of unemployment benefits, and also expansionary fiscal policies that were implemented in the first two years of difficulties. But the crisis also caused a dramatic drop in public revenues in Spain, because of declining tax revenues resulting from falling employment and the strong relationship between tax revenues and real estate, which collapsed after the bursting of the speculative bubble. This helps to explain the enormous impact of the crisis in Spain.

In just two years Spain went from a GDP surplus of 1.9 percentage points in 2007 to a deficit of 11.2 percentage points in 2009, the worst development across the European Union in that period, after the one registered in Ireland (–14 percentage points). Given the public deficit, financing needs sharply affected the public debt, which rose between 2007 and 2009 by 17.6 percentage points, from 36.3 per cent to 53.9 per cent, which was a very moderate figure in the European context.

The policy change slowed that trend in 2010, but it has not been able to reverse the situation, despite the intensive spending cuts, which have affected all policies, and the increase of virtually all taxes.

From 2009 to 2012 government revenues increased in relative terms by only 1.3 percentage points (from 35.1 per cent to 36.4 per cent of GDP) and spending increased by less than 1 percentage point (46.3 per cent to 47.0 per cent). Consequently, the total government deficit has dropped by only 0.6 of a percentage point (from –11.2 per cent to –10.6 per cent of GDP). Meanwhile, public debt has continued to rise very rapidly, as a result of continuing refinancing needs in the financial markets. In the context of serious uncertainties about the future of the EMU, bond yields reached bail-out levels, with the spread at an all time high. In 2012 the debt reached 84.2 per cent of GDP, and in 2013 it continued its upward trend.

Debt interest is growing every year, and in 2013 accounted for 38 billion euros, equivalent to 3.43 per cent of GDP (in terms of the national accounts). This is the second highest central state budget expenditure in 2013 (after pensions), much higher even than for unemployment (27 billion) or the total civil service wage bill (33.3 billion).

Advocates of mindless austerity explain the paucity of these achievements on the basis that spending cuts should be even greater, and recurrently look at two substantial areas in the central government budget: civil servants and pensions. Cuts have already been adopted: in the case of pensions, the freezing of its annual update (in 2011) and the elimination of the bonus corresponding to price rises (in 2013), despite being recognized by law. In the case of public employees, wages were reduced (by

5 per cent in 2010 and 7 per cent in 2012) and frozen in 2011.

But beyond these discretionary cuts, the real aim is structural reform of government (by reducing its workforce) and of the pension system (through the essential parameters that determine access and amount). These two reforms are being implemented by the Popular Party government. These two budget lines are the two major areas of public spending (along with health care, which is the responsibility of the Autonomous Communities) with enough significance to permanently bring about a substantial decrease in public spending (pension spending accounts for almost one-third of the total expenditure of the central government).

However, all indicators show that Spain, compared with the rest of the euro area, does not have a large public sector in relative terms (Spanish government expenditure as a percentage of GDP is around 5 percentage points lower than the euro area average). The spending in the public pension system is not unaffordable or unsustainable, beyond economic difficulties that are derived from the very heavy loss of employment and income already mentioned. Therefore, both reforms seem to be aimed at promoting the sustainability of the public finances; however, they rather seem to be promoting a paradigm shift in the Spanish public sector, as part of a huge remodelling of the welfare state.

In contrast to the above, the ineffectiveness of the measures taken to reduce the deficit and public debt has a threefold explanation: first, spending cuts have induced further contraction in economic activity and, consequently, in tax revenues, which has nullified the theoretical positive impact of fiscal consolidation. Second, the very high level of fraud and tax evasion in Spain (estimated at between 20 per cent and 25 per cent of total revenues) makes a huge gap in terms of fiscal pressure compared with the euro area average (about 9.8 points of GDP in 2012, exactly the same as it was in 2009). And third, the high cost of debt interest, a direct result of the erroneous policy implemented by the European institutions to tackle the crisis, especially the European Central Bank, which has highlighted the problems of structure and governance in the European Union. It is illustrative to analyse the evolution of Spanish risk premiums during the crisis, in particular two key moments: first, in April 2010, the month in which the financial crisis started in Greece and caused the shift to extreme austerity policies (this spilled over the following month to other European countries, including Spain), and when the Spanish bond spread with Germany began an unstoppable upward trend that saw its highest point in July 2012 (555 basis points monthly average). Second, in July 2012, when European Central Bank President Mario Draghi announced the decision of the governing body to act on the bond market in order to save the euro (»whatever it takes, and, believe me, it will be enough«, Draghi said) and to ensure affordable financing for the countries that compose it. This statement was enough to put the risk premium on a clear downward path.

It was not the austerity that brought calm to the markets, but the announcement that the ECB would act as a lender of last resort, the way the Bank of England or the Federal Reserve do.

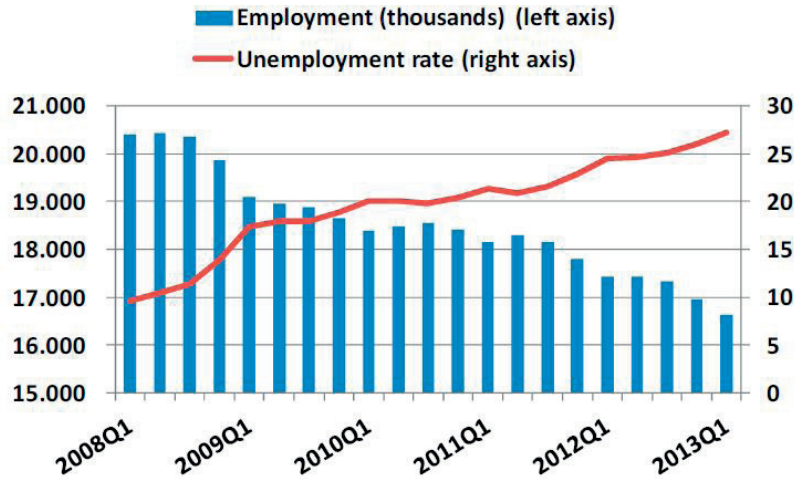
3. Employment and Working Conditions

3.1 Unemployment, Major Economic Imbalance and Social Problems

The economic crisis in Spain has had a devastating impact on employment. In five years it has destroyed 3.8 million jobs, the employment rate has fallen more than 11 percentage points, the number of unemployed has grown by 4 million and the unemployment rate has risen 17.5 points (from 9.6 per cent to 27.2 per cent the highest rise in history). As in the rest of the world, it began as a financial crisis, turning into an economic crisis in a few months, bringing forth latent structural problems in its growth model, and finally an employment crisis. High unemployment has become the major imbalance of the Spanish economy and the main source of social problems.

Current austerity policies seek (at least in theory) the recovery of employment through the creation of a virtuous circle that, allegedly, would in the short term lead to cheaper labour costs to gain external competitiveness, and in the medium and long term, to generate investor confidence through strict control of the deficit and public debt and the implementation of *structural reforms,* which essentially consist of market deregulation in order to generate a more efficient allocation of resources. Accordingly, employment is, from this perspective domi-

Figure 7: Employment volume (thousands) and unemployment rate (%)



Source: National Labour Force Survey (EPA). INE.

nant for the past three years, an intermediate target for achieving other objectives: strict control of public finance and deregulation/liberalization of markets, while denying any positive role for public initiatives.

But three years of strict application of this particular political and economic strategy should be enough to have induced some changes in employment trends, at least in the main labour market figures. If employment was, and is (as has been repeated by politicians) the target variable of the entire economic strategy, and employment needs are recognized, these policies should show a favourable impact on employment rates, either quantitative or qualitative. However:

- Job destruction has not slowed at all, and a relapse was observed in 2012, which was the year with the largest employment decline over the entire crisis since 2009 (850,400 employees). Overall, since the first quarter of 2010 1.77 million workers have lost their jobs, almost 10 per cent of previous total employment.

- All economic sectors have experienced job destruction, but in the past three years, in absolute terms, the service sector has shrunk more (43 out of 100 jobs lost, followed by construction, with 35 out of 100). This is because of what has happened since late 2011, when the service sector (which has best withstood the impact of the crisis from the beginning) began to lose jobs. If the whole building crisis explains more of the decline in employment (43 per cent), in the past year 58 per cent is due to services (466,000 fewer workers).

- Job destruction since 2010 is affecting foreign workers more than previously: while the first phase of the crisis this accounted for two out of 10 jobs lost, in the past three years it has accounted for three out of 10 lost jobs.

- From mid-2011 employment in the public sector, which until then had maintained positive rates, began to decline, and from the fourth quarter of that year at an increasing pace. It now exceeds the employment losses suffered by the private sector. This is a relevant result, as it is a direct outcome of the cuts applied in public policy at all levels. In the whole of 2012 and 2013, nearly one in every four jobs lost was in the area of Public Administration (290,300 out of 1,216,000).

- The evolution of employment by type of contract is especially interesting, to the extent that what has happened since 2010 severely qualifies the widespread perception that the crisis is affecting only (or mostly) temporary employment, while permanent jobs, which have high protection, are surviving this difficult period. But there are two different stages. In the first two years of the crisis it is true that almost all the employment decline was temporary, but in the past three years both temporary and fixed contracts have been affected in a similar way, to the point that at this stage permanent employment has been more affected than temporary jobs (53.4 per cent of the total, more than a million jobs, compared to 875,000 temporary ones).

- During the crisis the proportion of temporary workers has fallen from more than 30 per cent to 22 per cent, which is still very high in the European context, but the lowest rate in Spain since the late 1980s. This is solely due to the collapse of temporary employment (in relative terms it is greater than the total), and not to the impact of measures to that effect. It is, therefore, a passive reduction of the duality that cannot be understood as a change of present or future labour market composition.

- In a context of strong employment contraction since 2010 the number of self-employed workers has grown slightly (130,400 in total, 6.9 per cent). However, it is clear that it is not a signal of an increase in activity; it is explained by the transfer of workers who, unable to find paid employment, decide to try self-employment. It is thus an unwanted initiative overall, which is due more to necessity than to an increase in entrepreneurial activity. In other cases, this dynamic behaviour is also linked to companies that outsource some of their activities; turning fixed costs into variable costs and moving the market and production risk onto their former employees, who are now converted into self-employed (in fact, »false self-employed«).

- By type of working day, part-time employment has outperformed the contraction in activity, as it is the norm in economic crises, even retaining positive rates for most of it. It is noteworthy that since the start of 2012 part-time employment has enjoyed strong growth, while full-time work has decreased even further. In an optimistic interpretation, this process could be anticipating an overall improvement in employment. But there are no activity indicators to support this thesis. On the contrary, it appears that it reflects the transfer to part-time by previously full-time employees, and that due to economic difficulties, companies are changing their contracts to reduce costs and achieve more flexibility.

- In Spain, part-time employment is mainly an unwanted option, unlike in most of its European partners, and this feature has worsened during the crisis: over 60 per cent of workers declared that they have part-time jobs because they cannot find full-time employment, whereas this percentage was 31 per cent in 2008. It is, without doubt, an effect of high unemployment and cuts in revenues.

- Overall, the crisis shows a steady increase in the number of underemployed (working fewer hours than they want, or in jobs that require less skills relative to their qualifications). While underemployment has not changed much since 2010, it has continued to rise to 2.5 million workers, 15 per cent of the total workforce).

The decline in employment has, of course, led to a very strong increase in unemployment, as already mentioned. The worsening unemployment figures have been fairly widespread and a truly spectacular escalation, rising above 6 million unemployed (6.2 million in the first quarter of 2013). Unemployment rates have continued to grow during the period of austerity in Spain to very high levels in the European context, whatever the group of workers studied. The overall rate has increased throughout the crisis by 17.5 percentage points (7.1 percentage points in the past three years), and in the first quarter of 2013 stood at 27.2 per cent, the highest in the European Union.

While unemployment among the under 25s has doubled during the crisis, unemployment among 45–55 year-olds has multiplied by 3.6. If at the beginning of the crisis, unemployment greatly affected young people, focusing on the non-renewal of temporary contracts, since 2010 it has affected older workers with more experience, the structural part of the workforce. Four out of ten new unemployed in the past three years are older than 45, seven out of ten if we take those over 35 years. Those workers have greater difficulty in re-integration, as many of them come from traditional sectors and construction, whose skills do not easily transfer to other sectors. The situation has worsened as the government has reduced the amount allocated to active labour market policies over the past three years, which has been cut by 4 billion euros, more than halving the initial budget.

The number of long-term unemployed (those who actively seeking jobs and have been unemployed for more than one year) is growing steadily, now standing at 3.5 million, 56 per cent of the total. Of these, 2.1 million have been looking for two years or more. Half of this long-term unemployment has been generated in the past three years. In fact, all of the increase in unemployment is due to this component, which gives an idea of the labour market paralysis and lack of prospects.

The consequences are severe because these long-term unemployed are at the core working age, and most of them have family responsibilities. Those who are exhausting their unemployment benefits are being affected by poverty and social exclusion. The number of households in which all active members are unemployed has increased almost fourfold during the crisis, and has now reached 1.9 million. In 2012 and so far in 2013 this figure has continued to rise. Since 2010 it has also increased the proportion of those who do not receive any income (not only unemployment benefits, but also other types of income such as a pension), from 20 per cent to 25 per cent.

To sum up, these features show that the crisis and the policies applied are not slowing job losses. On the contrary, they are raising unemployment in Spain, which is becoming structural, with a high economic and social impact that hampers any possible recovery. In addition, there has been an overall increase in precarious employment, which makes workers more vulnerable (less stable, lower pay, more underemployment and increased worker dissatisfaction). This has serious consequences for poverty and inequality.

3.2 Labour Market Deregulation: The 2012 Reform

Legal changes in the labour market should be considered part of the *austerity agenda,* although they do not have any direct impact on public finances. The labour market reform has been one of the basic elements of all the recommendations of the Troika and other national and international institutions (Bank of Spain, OECD) in the same neoliberal ideological orbit.

Since 2010 Spain has implemented three changes in the field of labour relations. The relevance and extent of these actions qualify as *labour reforms* (in 2010, 2011 and 2012), and all of them have been carried out unilaterally by the government, without reaching an agreement with the social partners. All these reforms outline in their explanatory statements, more or less explicitly, three objectives: establish conditions to boost job creation or slow job destruction; reduce labour market segmentation between permanent and temporary workers; and raise labour market efficiency, increasing flexibility for companies and enhancing worker security. But the truth is that actual policy measures have been inspired (admittedly by varying degrees) by the doctrine labour market defended by international institutions mentioned above.

The results show that none of these reforms has met the goals that supposedly drove them. However, they have been taking progressive steps in the formation of a more deregulated labour market, and have affected the balance of power in collective bargaining within firms. This has a substantial economic impact, because collective bargaining is the initial instance that determines the primary distribution of income, as the distribution of the generated added value between wages and profits. The more unbalanced is the first distribution, the harder it is to promote a less unequal society through the instruments of fiscal policy (taxes, benefits or other transfers). It also directly affects the levels of labour productivity and workers' quality of life.

The reform passed by the Parliament in 2012 was the most intensive and substantial in the past twenty years and represents a quantum leap in deregulation. On one hand, it continues with the changes and reforms mentioned above; on the other, it introduces new substantial changes, especially in the area of collective bargaining, by removing a wide number of guarantees for workers.

The reform largely complies with the traditional demands of business organizations and international institutions (IMF, ECB, OECD). In this regard, this reform promotes a paradigm shift of labour relations in Spain and not a mere modification of the existing model created by the adoption of basic labour standards, which was adopted in 1980 (Workers' Statute). This reform is set to change the correlation of forces in labour relations in favour of employers and to the detriment of workers.

The amendment was approved just a month after the social partners signed an agreement which was valid for 2012–2014 (II Agreement for Employment and Collective Bargaining 2012–2014) in which they negotiated changes in management mechanisms governing labour conditions in order to increase flexibility and to moderate wages significantly over the whole period, to be matched by a moderation of profits for the sake of gaining competitiveness in the short term. But the government's labour reform, affecting virtually all issues in agreements and giving employers discretionary powers, went far beyond the provisions of agreements between employers and unions, and left agreements with little practical validity.

Table 1: Main measures implemented by labour market reform, 2012

Hiring and employability:
Creation of a new indefinite contract *benefiting employers* for companies of fewer than 50 workers, with economic incentives and a probation period of one year (free dismissal, without cause and indemnification during that year).
Modification of *training contracts,* extending the maximum age to 30 years old and making it more flexible.
Possibility of extraordinary hours in part-time contracts.
Categorisation of temporary job agencies as placement agencies.
Annual 20 hours paid leave for training for workers with at least one year at the firm.
Dismissal:
The amount of severance pay due in case of dismissals without just cause was lowered from 45 to 33 days a year, with a maximum of 24 monthly wages instead of 42.
Abolition of so-called *express dismissal,* in terms of which the employer disregarded the inappropriateness of the dismissal in order to make its effects immediate, against a severance payment equivalent to 45 working days' wages for each year of employment at the firm.
Extension of dismissal for *objective causes* (indemnification of 20 days per year, with maximum of 12 monthly wages), especially for economic reasons.
Modification of working conditions:
Increase of enterprises' ability to unilaterally modify working conditions, including wages.
Extension of firms' possibility to deviate from collective agreements with regard to working conditions. Possibility of submitting discrepancies to obligatory arbitration.
Collective bargaining:
Giving priority to agreements at company level over those at sectoral level.
Elimination of automatic extension of collective agreements after expiry: collective agreements cease to apply a year after expiry if no new agreement has been reached.

Source: Authors' elaboration.

A year after the reform, we can highlight some of the results. It has not slowed job losses or reduced unemployment; it has not increased the total proportion of permanent contracts; the new *contract for employers* is used only marginally; the number of collective redundancies has increased (especially those *not agreed* between the parties), as have the criteria for objective individual dismissals (those with lower compensation, 20 days per year worked); it has weakened the bargaining position of the trade unions and collective bargaining has decreased (the number of workers covered by collective bargaining is the lowest for many years).

But the main result of the reform is wage cuts. In a scenario of recession and high unemployment, the great power given to employers by the Popular Party labour reform has caused wages to plummet. It was, in short, a key aim to establish *wage devaluation,* which it is being proposed by national and international bodies as a mean of increasing competitiveness for countries with public finance difficulties.

3.3 Wage Devaluation as a Way Out of the Crisis

According to the theory that supports the austerity policies, to the extent that it is not possible to implement incentives to economic recovery on the spending side because of the imbalances in public finances, the only way is to influence *the supply side,* improving enterprises' production to increase their competitiveness by increasing productivity and reducing costs. To achieve the needed productivity gains, market reforms are required (for example, concerning labour) that require some time to bear fruit. Therefore, in the short term, the solution is to reduce business costs, so-called *internal devaluation,* which produces an effect similar to currency devaluation, which is now impossible because Spain is part of the euro zone. But as the only really controllable costs are wages, internal devaluation translates into *wage devaluation,* the widespread and drastic cutting of wages.

This approach to wages considers them solely as a cost of business, but not their function as source of income for a large part of the population and thus one of the key drivers of domestic demand and production. Thus, despite a situation of recession and high unemployment, as in the crisis in Spain, and in the absence of strong external demand due to the similar situations experienced by most EU countries, a strongly *procyclical* policy is being implemented and it is only feeding the contraction of the economy.

Wages in Spain have increased moderately for decades and have not been a source of conflict. Overall, in the most recent period of growth (1994–2007) wages grew slightly above prices, thereby gaining purchasing power, but less than productivity, so that firms' costs fell and thus they made significant profit gains. Meanwhile, employment grew more than in any other EU country.

This peaceful evolution, which achieved positive results for all parties, was helped by the social climate based on dialogue, which culminated in numerous collective agreements between employers and labour organizations. Specifically, from 2002, the social partners signed agreements at national level that reflected the common provisions that they sent to their negotiators at different levels (firm, sectoral). In those agreements, the social partners shared a wage model based on wage increases higher than inflation but lower than productivity. This dynamic of social dialogue (firms, unions) has continued despite the crisis, and it was reflected in the *Second Agreement on Employment and Collective Bargaining* in January 2012, which reflected new wage criteria for dealing with the crisis, including increases in 2012–2014, which were related to changes in GDP and involved very significant losses of purchasing power but a noticeable reduction in costs for businesses.

But the labour reform blew this agreement out of the water, imposing new rules that gave even more power to employers, far beyond what was proposed in the agreement, without negotiations with workers. It shows a clear commitment to establishing a new model of labour relations based on authoritarianism rather than on dialogue and consensus. The impact on wages has been substantial.

It should be noted that, since the beginning of the crisis, wages have developed moderately, for two reasons. First, because the impact of economic difficulties, with dramatic job losses, has modified the balance of power in companies and necessarily gives priority to employment versus wages; and second, the responsible action of the social partners, with the signing of agreements at national level, taking into account general macroeconomic objectives and avoiding possible conflicts and lack of coordination in different areas of collective bargaining. Thus, wage increases were gradually reduced in the agreements, so that in most years wages lost purchasing power as they grew less than inflation (the exception was 2009, due to the sudden and unexpected fall in consumer prices, and 2010, which saw a very small gain). Between 2010 and 2011 wages lost 1.7 percentage points of purchasing power, and this was repeated in 2013.

Similarly, nominal labour and wage costs have been continuously moderating during the crisis, to the point that in 2012 they recorded a negative rate. In 2011 labour costs rose slightly, but this was not due to changes in wages, but to severance payments, as employment cuts affected workers with permanent contracts, which are more costly to terminate. Once adjusted for inflation, wage costs in real terms declined from 2010 to 2012 by 6.4 per cent. This has continued in 2013.

The data provided by the National Accounts are probably the most explanatory, since they offer a broader perspective on the effects of all components involved in the primary distribution of income from production. Table 2 summarizes the evolution of all its main components:

Table 2: Labour costs and income distribution indicators (annual growth rates)

	2008	2009	2010	2011	2012
Compensation of employees	6,6	-2,4	-2,3	-0,8	-5,4
Number of employees	-0,2	-6,3	-2,5	-1,5	-5,1
Compensation per employee	6,9	4,2	0,3	0,7	-0,3
Labour productivity	1,1	2,7	2,3	2,2	3,2
Nominal Unit Labour Costs (NULC)	5,7	1,5	-2,0	-1,4	-3,4
Inflation (Deflator of GDP)	2,4	0,1	0,4	1,0	0,1
Real Unit Labour Costs (RULC)	3,3	1,4	-2,4	-2,4	-3,5
Gross operating surplus	3,8	-2,6	-1,0	5,0	2,2

Source: Compiled from Annual and Quarterly National Accounts (INE).

This shows how, after growing in 2008 (the year in which the crisis was still denied by the authorities and in any case its depth could not have been known), employees' remuneration has been falling continuously since 2009 (by a total of 10.9 percentage points). The intensity of this decline by European comparison is highlighted if we eliminate the apparent effect of prices, thus yielding workers' real compensation. In the period 2010–2012 Spain suffered the second largest decline (–14.8 per cent), after Greece (–30.9 per cent). As expected, the top positions in this classification belong to the other countries currently suffering most intensively: Portugal, Ireland, Italy and Cyprus. This is proof that, beyond other considerations, wage devaluation is still one of the most prominent results of austerity policies.

The collapse of total wage income in Spain is due mainly to the sharp fall in wage employment, but also to wage restraint, which in 2012 reduced wages in nominal terms. If productivity is discounted it gives us nominal unit labour costs (cost of producing each unit of output). Because productivity in Spain has grown significantly during the crisis because of the very strong decline in employment costs per unit of output have fallen very sharply in the past three years, by 6.6 per cent in total. That means that companies increasingly produce more cheaply and they are becoming more competitive on costs.

This, which is the essence of the theory of wage devaluation, is the combined result of the pressure of high unemployment, cuts (for example, in public workers' wages) and labour reforms, especially in 2012.

However, although some export activities have resulted in price suppression, which has resulted in short-term market gains, overall performance is not so favourable. By contrast, despite the deflationary impact of wages, prices are rising (as reflected in both the CPI and the GDP deflator), because business gross profits, after a slight adjustment in 2009 and 2010, returned to growth in 2011 and 2012. In terms of competitiveness, this increase of enterprise gross profits is jeopardizing part of the effort made by employees. In sum, wage devaluation, overall, is not expanding demand, but rather entails a substantial transfer of income from employees to firms.

The change in real unit labour costs indicates a transfer of income from employees to firms of 8 per cent since 2010. The consequence is that the share of employee compensation in GDP is declining: since the first quarter of 2009 it has fallen 5 percentage points, from 49.7 per cent to 44.7 per cent, while business profits have increased from 42.5 per cent to 46.3 per cent. Since the fourth quarter of 2012 business surplus has outweighed workers' compensation for the first time.

Moreover, Spain is among the countries of the euro zone with a relatively low share of wage income in GDP, again the result of the drastic intervention and adjustment imposed by European institutions. This is further evidence that competitive devaluation, far from being neutral, has obvious winners and losers.

We cannot ignore the effects of austerity policies on the minimum wage. In contrast to what happened in the period 2004–2009, when the minimum wage increased by 38 per cent (6.4 per cent per year), exceeding the symbolic figure of 600 euros a month (624 euros in 2009), since 2010 the minimum wage has barely grown, rising by an annual average of 0.85 per cent to 654.30 euros a month (in annual terms, with fourteen paydays). This means that, given the evolution of the CPI in this period, the minimum wage in real terms has fallen by 6.1 percentage points (as of June 2013). The minimum wage in Spain is only 35 per cent of the average wage, one of the lowest of all countries in which the EU has established a minimum wage job reference in its regulations.

In addition to its direct impact on the quality of life of the recipients, an additional non-negligible effect of this is that it reduces social security contributions, at a time when financial difficulties resulting from the decline in employment are evident. Thus workers are likely to receive lower pensions in the future.

4. Fiscal Consolidation and Social Spending

In contrast to other continental and northern EU members, but similar to other southern European countries, the welfare state in Spain is close to the so-called »Mediterranean model«, characterised by less developed social policies, undeveloped institutions and lower levels of social spending.

As in the rest of the European Union, the Spanish welfare state has been the subject of various debates regarding its sustainability and efficiency.[1] During the first years of democracy, efforts were made to extend the education and health care systems, while social security experienced various reforms during the 1980s and 1990s in order to increase its sustainability. Labour market reforms were also supplemented by unemployment benefit reforms.

New social policy paradigms[2] are aimed at developing a more proactive, dynamic welfare state, whose main target is to promote »active citizenship«, with intensive investments in early stages of life through education and preventive health care, while bringing about higher participation on the part of beneficiaries in the traditional pillars of protection against illness, unemployment and old age.

1. Moreno, Reformas de las Políticas de Bienestar en España, Siglo XXI Editores. 2009.

2. Mulas-Granados, *El Estado Dinamizador,* Editorial Complutense-FIIAPP, 2009 and Giddens, Diamond and Liddle, *Global Europe, Social Europe,* Polity Press, London 2006.

In Spain, changes in social policy financing are only partially aimed at promoting these reforms. Budgetary constrictions due to fiscal consolidation have led to a lower level of social spending, and budgetary cuts are more focused on social investment (health care, education) rather on more passive protection (pensions and unemployment). The fiscal consolidation path does not allow a proper debate on the future of the Spanish social model, and, in a way, austerity is undermining the capacity of Spanish social policies for further modernization.

According to Eurostat, Spanish social spending has traditionally been lower than the EU average. While the EU average is around 25 per cent of GDP (excluding education), social spending in Spain remained at around 20 per cent (excluding education) during the years prior to the crisis. At the beginning of the crisis in 2008, and until 2010, Spanish social spending rose to 25.7 per cent of GDP (excluding education).

A proper analysis of this figure must include a detailed study of its different components: health care, pensions, unemployment and other social protection expenditure.

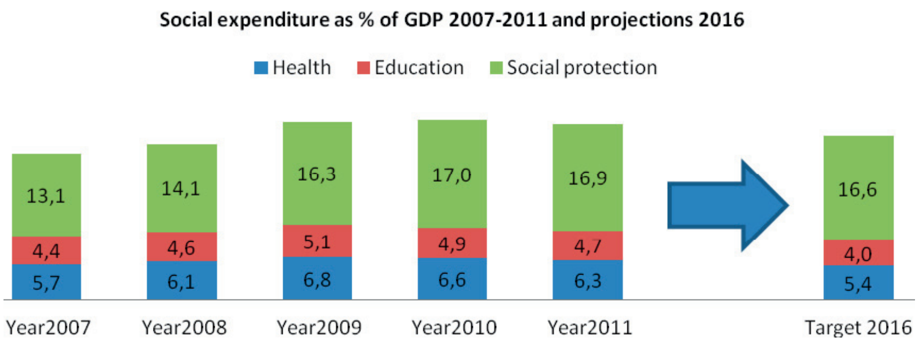
Regarding health, expenditure peaked in 2009 at 6.8 per cent of GDP, before starting a decline to 6.3 per cent of GDP in 2011. It is expected than measures taken by the Popular Party government in 2012 will reduce public health care expenditure during the coming years, and the Stability Programme of 2013–2016 set the health expenditure target at 5.4 per cent of GDP in 2016.

Education expenditure also peaked in 2009, at 5.1 per cent of GDP. Spending was reduced in 2010 and 2011 to 4.7 per cent of GDP. The Spanish Stability Programme aims to reduce it further to 4.0 per cent of GDP in 2016.

While it represented 13.1 per cent of GDP in 2007, just before the crisis, social protection peaked in 2010 at 17 per cent of GDP, declining to 16.9 per cent of GDP in 2011. The main factor in this increase was the rising unemployment benefits (from 1.6 per cent of GDP in 2007 to 3.2 per cent in 2010) and pensions (from 10.3 per cent to 12.3 per cent of GDP). According to the Spanish Stability Programme, social protection will decline to 16.6 per cent of GDP in 2016.[3] As a whole, social expenditure is expected to be reduced in the next

3. Spain Stability Programme 2013–2016. Updated in April 2013.

Figure 8: Social expenditure as a percentage of GDP, 2007–2011 and 2016 (projection)



Source: EUROSTAT and Spain Stability Programme 2013–2016.

three years as a percentage of GDP, to the levels existing before the crisis.

These projections suggest that, in real terms, in 2016, social expenditure in Spain (social protection, education and health CARE) will be reduced by 6 per cent from 2011 data. Health care and education will be reduced by 15 per cent and social protection – pensions and unemployment benefits – will be reduced by 1 per cent. As a result, those areas more related to social investment (education, health care) will suffer the highest reduction, while passive protection – unemployment, pensions – will maintain relative stability.

We will examine the various components of social expenditure and the different measures taken in order to reduce them as a percentage of GDP.

4.1 Health Care Spending

After a decade of steady growth, public expenditure on health care has suffered a decline of 10 per cent between 2009 and 2013. Most of the previous increase (from 5.2 per cent of GDP in 2002 to 6.8 per cent in 2009), was produced due to the decentralization of the National Health Service from central government to the regional governments. In 2009, regional governments managed 90 per cent of total public health expenditure, with huge differences between them. For example, the regional government of the Basque Country allocated 1,632 euros per capita in 2011, while the regional government of Andalusia spent 1,121 euros per capita. These regional differences in public health care provision make it difficult to achieve proper control of health finances. As a whole, public health care has experienced declining expenditure since 2009, especially since the beginning of fiscal consolidation.

The main restructuring of the health care system is based on Decree-Law 5043/2012, adopted in April 2012. This decree establishes new parameters for the national health care system, including the following:

- A new classification of beneficiaries. Irregular immigrants older than 18 years of age receive free health assistance only in emergencies, birth and pregnancy.

- A new portfolio of services, which makes a distinction between basic and complementary services. It is expected that complementary services will be paid for, totally or partially, by users.

- A new system of pharmaceutical services, including intensive use of generic drugs, the exclusion of some products and the establishment of a co-payment system where users have to pay a percentage of the pharmaceutical products they use.

Additional measures were taken in order to increase the working hours of health personnel, push the retirement of older health workers, not to allow the substitution of retired staff and freeze new public investments in the health system. In 2012, some regional governments initiated a new round of privatization in order to save costs and to allow private initiatives to manage some hospitals. Madrid allowed six centres to be managed by private firms.

As a result, regional governments' public expenditure per capita on health care has declined in real terms. According to the initial annual budget, annual budgets for 2013 are, in real terms and on average, 17 per cent lower than those approved in 2010.

This reduction is not uniformly distributed. Differences vary from 29 per cent budget cuts by La Rioja regional government to 2 per cent budget cuts by Asturias government for the period 2007–2013. Other regional governments with substantial budget cuts include Extremadura (–22 per cent), Andalusia and Valencia (both with budget cuts of –18 per cent). This diversity in the impact of budget cuts is not clearly related to any kind of harmonization of regional expenditure on health care. While variation among regional governments increased during the first part of the crisis, fiscal consolidation has reduced it slightly.

In conclusion, regional governments, which are in charge of health care, have reduced spending by 13 per cent on average since the start of the crisis, but with diverse consolidation paths. As a result, while convergence in health spending has been increasing since 2010, previous divergence from 2007 to 2010 is still defining regional differences in the national health system.

It is expected that health care budgets will be subject to further reductions in order to reach the stability programme targets. These new reductions will arrive with the full implementation of the public health care system reform established in 2012, but whether this reform will be enough remains unresolved. The reform is also subject to a strong political debate as some regional governments claimed that it could infringe regional competences, and it is now under review by the Spanish constitutional court.

4.2 Public Spending on Education

As in health care policy, education has been provided by regional governments since the beginning of 2003, and this has led to a huge divergence in expenditure. During the past decade, public expenditure in education as a percentage of GDP has been lower than the EU27 average. It peaked in 2009 at over 5 per cent but declined in 2010 and 2011.

Lower investment as a percentage of GDP is due to Spain's demographic pyramid, with fewer people of the relevant age. In terms of spending per student, Spain allocates a higher amount than the European Union and the OECD averages, at all educational levels.

Nevertheless, this amount per student has fallen. In current US dollars, in 2010 Spain allocated less money per student than in 2009, when the average amount per student was 10,094 US dollars per student. According to the OECD education-at-a-glance indicators, public expenditure per student had different paths according to educational level. Spending at primary and secondary levels rose by 16 per cent between 2005 and 2009, to decline in 2010, while spending at tertiary level rose by 13 per cent in only two years since 2005, to be frozen between 2008 and 2010.

While some regional governments started to introduce adjustment measures in 2010, most of the adjustment in education spending was implemented by the Popular Party government in 2012, through new legislation on the rationalization of public education expenditure. This act (Decree Law 14/2012) contains a number of measures to guarantee the sustainability of public education finances. These measures are as follows:

- increase the ratio of students per classroom to 20 per cent;
- establish a lower limit of teaching hours per teacher at 25 hours per week in primary education and 20 hours per week in secondary education;
- tighten the capacity of schools to substitute teachers with temporary staff;
- rationalize the capacity of public universities to propose and to offer new university degrees;
- reinforce the review and evaluation of university lecturers and professors;
- impose a balanced budget on universities;
- increase university fees;
- narrow the criteria for the granting of scholarships.

As the education system is highly decentralized, regional governments have responded in different ways to the budget cuts in education. For example, the regional government of Madrid has imposed an aggressive adjustment in public education, including the reduction of temporary teachers, the introduction of new tuition fees in secondary education and an increase in public university fees. Between 2009 and 2013, public university fees in Madrid increased by 82 per cent in real terms for degrees with the highest level of lab work (for example, medical studies).

Due to the measures taken by the government in 2012, scholarships suffered a decline in the last academic period. After similar evolution between total budget and beneficiaries, in 2012 the total amount allocated to scholarships decreased. Additionally, the increase of beneficiaries due to the crisis has resulted in a higher reduction of the average grant per student, which was, for the academic year 2012–2013, around 88 per cent of 2007 figures in real terms.

The development of other forms of financial aid has a different profile. Such assistance includes a gratuity for books, meal subsidies and other benefits not related to education fees. While during 2007–2011 the development of the budget and beneficiaries was similar, and therefore the average financial aid per student remained stable, in 2012 a dramatic drop in the budget and the tightening of the eligibility rules led to the result that for those students who still received financial aid the average support granted per student has fallen by up to 50 per cent in recent years.

The reason for this different development of scholarships and other forms of financial support is the change in the eligibility rules for financial support. Until the academic year 2012–2013, several regional governments guaranteed a subsidy for books for all students, in the academic year 2012–2013 a number of regional governments – for example, La Rioja – terminated this system and substituted it by a system aimed at the poorest families. Other regional governments tightened the eligibility criteria, such as the regional governments of Valencia and of Madrid. As a result, beneficiaries of such programmes declined by 60 per cent from the previous academic year.

As a result of all these changes, public expenditure on education has been reduced in recent years, and especially during 2012, with a reduction of the budget allocation per student, an increase in education fees and a reduction in average grants and other financial support. All these adjustments represent a reduction of 4.03 per cent in real terms from 2011 to 2012.[4] Further cuts are likely in order to achieve the targeted 15 per cent budget cut between 2011 and 2016, according to the abovementioned stability programme.

4.3 Pensions

Pensions are one public budget line that has not suffered a real decline since the beginning of the crisis. In fact, in the years before the crisis, public pensions registered enough surpluses to generate a »reserve fund« to be used during recessions and economic crises. The Spanish pension system is pay-as-you-go, based on contributions from current employers and workers, which are used to pay current pensions. Since the beginning of the crisis, the pension budget has increased by more than 15 per cent in real terms.

This evolution of the total budget is due to two reasons: the increase in the number of beneficiaries, which rose from 8.4 million in 2008 to 9 million in 2013, and the political commitment to an annual revalorization of pensions. While during the first part of the crisis, revalorization was fairly strong, it has slowed down since the beginning of fiscal consolidation in 2010. Between 2008 and 2010, real growth of the average pension was 6.35 per cent, while between 2010 and 2013 is has been 1.34 per cent. In 2012, the monthly average pension was 836 euros.

This average hides a number of specific developments. In 2011, only minimum pensions grew; the rest were frozen by the government.[5] In 2013, the government decided again that only minimum pensions and those below 1000 euros a month would grow, by 2 per cent, leaving the rest with an increase of 1 per cent for 2013. To some extent, the evolution of average pensions since 2010 is the result of a narrowing of the range of pensions rather than their increase. Taking, for example, retirement pension with one dependent and the highest allowed pension,

4. Ministry of Education, »La educación en cifras curso 2012–2013«, Madrid 2013.

5. Royal Decree 1794/2010.

the lower pension grew by 8 per cent between 2008 and 2010 and has remained relatively stable since then; during the same period, and after an increase of 3 per cent between 2008 and 2009, the purchasing power of the highest allowed pension decreased by 4.1 per cent before tax between 2009 and 2013.

Other types of pensions include non-contributary illness and retirement pensions, which are awarded to people who were not able to make enough contributions to the pension system. There were a total of 445,278 beneficiaries in 2012. In this case, the evolution of total budget and average pension differs. The decline in the number of beneficiaries led to a decline in the general budget in real terms and, therefore, to an increase in real terms of average non-contributary pensions between 2008 and 2011, falling in 2012 to 1 per cent of the total real increase between 2008 and 2013. For 2012, the monthly average non-contributary pension was 360 euros, less than half the general average pension. In 2013, the government took the decision not to finance such pensions with social security funds, but with the general budget, as part of its social policy programmes.

While pensions have been affected by fiscal consolidation, social security finance and future sustainability remain important issues for Spain. The social security system was able to generate a surplus between 2000 and 2009, creating a reserve fund of 66 billion euros in 2011. Social security entered into deficit in 2010, with no recovery between 2011 and 2012.

The reason behind this tendency towards deficit was the huge increase in unemployment and the decrease in the number of contributors, which reduced system revenues while system expenditure continued to grow in real terms. As a result, in 2012 the government had to draw on the reserve fund in order to meet pension payments.

Taking a long-term view, the sustainability of the social security system has been seen as difficult to guarantee in its current model. As Spain maintains a pay-as-you-go system, demographics are against it if no action is taken. Longevity and an increase in the number of old people, together with a lack of working young people is worsening the dependency rate. It is foreseen that in 2060 Spain will have twice the number of beneficiaries of public pensions – up to 16 million – increasing the proportion of GDP spent on public pensions in the long term.[6]

The long-term sustainability of the social security system is more related to Spain's capacity to repay public debt than to the current public deficit. The IMF,[7] the OECD[8] and the European Commission[9] have recommended that Spain review its social security system in order to guarantee long-term sustainability.

In 2011, the government launched a reform of the social security system, postponing the retirement age from 65 to 67, and increasing the contributary period from 35 to 37 years. The measure will be progressively implemented, starting in 2013, and it will delay the retirement age one month per year until 2027.[10] In 2013, conditions for early retirement were tightened, increasing the number of contributing years to 35 and including the possibility of partial retirement.[11]

In 2013, the government issued a report on the sustainability of state pensions, whose conclusions will form part of a new reform. The report, signed by a group of experts, includes some conclusions about the sustainability of pensions, such as the »sustainability factor«, which would allow government to adjust the amount of future pensions to specific circumstances, such as longevity and the system's financial strength. The report also suggests decoupling the level of pensions from inflation.[12] The conclusions of the report are intended to be implemented in 2014–2019.

In conclusion, while pensions have been increasing even since the start of fiscal consolidation in 2010, this increase is more related to the increase in the number of beneficiaries rather than an increase in benefits. The average pension grew in the first part of the crisis but remained stable after 2010 and, while minimum pensions are still growing, other pensions are losing purchasing power. In order to continue along the fiscal consolidation path,

6. European Commission Ageing Report 2012.

7. IMF Country Report 13/245 Spain. Chapter IV Consultations.

8. OECD Pensions Outlook 2012.

9. European Commission Recommendations for Spain 2013, COM(2013) 359 final.

10. Law 27/2011.

11. Royal Decree Law 5/2013.

12. Report of the Experts committee on the sustainability factor for the public system of pensions. June 2013.

new losses of purchasing power are expected. At the same time, the social security system is being subjected to substantial reform in order to guarantee its long-term sustainability. This reform will undoubtedly drive pensions downwards, in both nominal and real terms.

4.4 Unemployment Benefits

Due to the situation on the Spanish labour market, public spending on unemployment benefits has increased dramatically since 2007, rising from 1.6 per cent of GDP in 2007 to 3.2 per cent of GDP in 2010. Although unemployment has continued to increase, since 2010 the unemployment benefits budget has not grown and has even been reduced. At the same time, there has been a substantial deviation between the initial budget and the final budget, which has been systematically higher than expected, due to the negative evolution of the labour market. This mismatch represented around 1.5 per cent of GDP in 2009, and while in 2010 the initial and final budgets were almost balanced, in 2011 the final budget was again higher than the initial one, and estimates for 2012 are also for expenditure higher than the initial budget.

As unemployment has risen dramatically in Spain and the number of long-term unemployed has increased, many unemployed people have ceased to receive unemployment benefit from the contributary scheme (unemployment insurance) and now receive it from the non-contributary scheme (unemployment benefit). Finally, some have ceased to receive any form of benefit, yet have no chance of getting a job. While in 2008 beneficiaries of non-contributary schemes made up 39 per cent of total beneficiaries, in 2012 the percentage was 53 per cent. At the same time, the coverage rate (percentage of registered jobless who receive any kind of benefits) fell from 73 per cent in 2008 to 62 per cent in mid-2013, after peaking at 78 per cent in 2010. Average benefit has developed in a similar direction to the budget and the coverage ratio. In real terms, it grew between 2008 and 2009 by 3.6 per cent; after that, it started to decline and between 2009 and June 2013 average unemployment benefit lost 7.8 per cent of its purchasing power.

The Spanish government has taken various measures to manage unemployment insurance and benefits during the crisis. The first bold initiative was launched in 2011: a new plan to support those who have ceased to receive any kind of unemployment benefit (the PREPARA plan), aimed at getting the unemployed to obtain new qualifications and to help them get a job. The PREPARA plan allocated between 400 and 450 euros monthly, for a maximum of 6 months, with no possibility of renewal. Beneficiaries must comply with strict eligibility criteria, including the net revenues of the household, participation in active job seeking programmes and other requirements. The PREPARA plan will be active until unemployment is below 20 per cent.

At the same time, in 2012 the government lowered the amount of monthly benefit from the sixth month of unemployment by 16.7 per cent and started to implement tighter control over fraud.

4.5 Other Social Expenditure: Housing, Families, Children and Social Exclusion

In addition to these major elements of the social model (health care, education, pensions and unemployment), Spain has allocated around 1.5 per cent of GDP to other social programmes: children and families, combating social exclusion and social housing. As the programmes are much decentralized among the different levels of government (regional, local and central) the available data do not allow us to carry out a detailed description. Data collected by Eurostat show that, while such social expenditure grew between 2008 and 2009 by 8 per cent it declined again in 2010 (no available data since then).

4.6 Conclusions

The welfare state in Spain has gone through two phases since the beginning of the crisis. Between 2008 and 2010, general social expenditure grew in response to the worsening of economic and social conditions. After the beginning of the fiscal consolidation process in 2010, a number of changes have been made. The first is the change in the relative composition of social expenditure, with less weight for health care and education, and more for pensions and unemployment.

At constant prices, public spending on health care, education and unemployment declined in the second part of the crisis (since 2010), while pensions remained the only public social programme to experience real growth. At the same time, the growth in pensions was due to the increase in the number of beneficiaries, while most individual beneficiaries suffered losses of purchasing power.

Second, as there is not a broad debate on the Spanish social model, fiscal consolidation and long-term sustainability have been the drivers of reform, rather than system modernization or improvements in its capacity to face the social reality of the crisis. Public finance savings due to the budget cuts have not been re-allocated to improve the capacity of the system to protect the most vulnerable people, nor to provide for new social investment in health and education.

Recommendations by the OECD and the European Commission suggested that Spain should pay more attention to social exclusion, and especially to child poverty, implementing specific programmes. The Spanish social model, which is based on an income guarantee system aimed at supporting the middle class, is failing to protect those below the poverty line, while support for the middle classes is being reduced.

In accordance with the stability programme, social expenditure will be reduced even further in the coming years, by 14 per cent in the case of health care and education, and by 1 per cent in the case of pensions, unemployment and other social protection programmes. According to the available data, between 2011 and 2013 only a part of this adjustment has already been made. Major reforms should be taken if Spain wants to comply with the fiscal stability targets, in a worsening context of persistent unemployment and increasing poverty.

5. Effects of Austerity on Social Cohesion

Since the start of the economic crisis, social cohesion has been substantially damaged by economic developments and fiscal consolidation. There are at least two channels of transmission between austerity and social cohesion. The first is the economic channel. Fiscal austerity is affecting the capacity of government to make public investments and to maintain public consumption. This lack of public economic activity is affecting domestic demand and, therefore, worsening overall economic output. With a shortage of domestic demand, unemployment rises and average real wages decline, leaving families with less disposable income, with a more unequal income distribution and increasing the risk of poverty and social exclusion.

The second channel of transmission is the lack of a proper answer on the social policy side. As social expenditure declines, families receive less social benefits, further reducing their disposable income. At the same time, reduced social programmes are unable to face the challenge of an increasing risk of social exclusion, resulting in more precarity.

As a result of both processes – diminished economic opportunities due to the lack of economic dynamism and reduction of the capacity of the social safety net to respond to the crisis – social cohesion has been strongly affected.

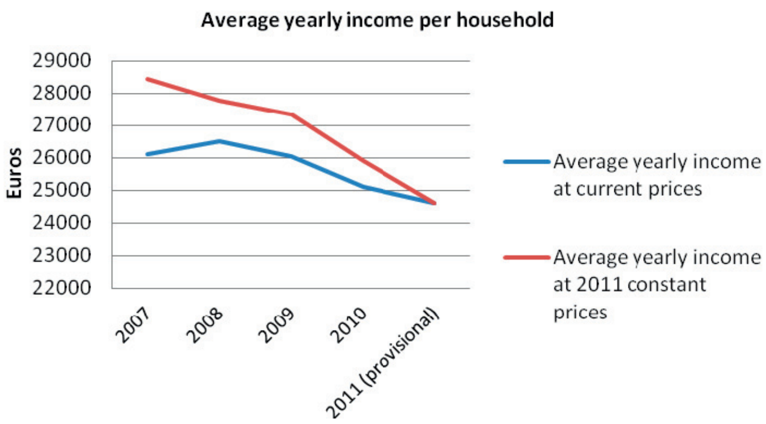
5.1 Economic Effects of Austerity on Spanish Households

According to the National Institute of Statistics, average household net disposable income, which is income from wages and transfers net of taxes, has declined since the start of the crisis, both in nominal and real terms. In nominal terms, it fell 5 per cent between 2007 and 2011; however, taking into account inflation, it dropped by 13.53 per cent.

This figure clearly shows the effect of internal devaluation: real decline of wages and social transfers has clearly affected the net revenues of Spanish families, increasing their difficulties in meeting daily life needs. The percentage of households finding it difficult to make ends meet has increased by 5 percentage points since the start of the crisis, and according to a set of seven basic consumption criteria, between 2007 and 2012 the proportion of families deprived of three or more of these criteria increased from 11.4 per cent to 15.5 per cent.

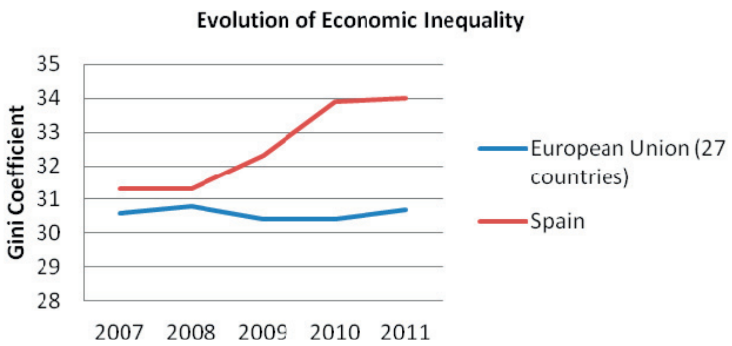
Due to rising unemployment, the number of households in which no one has a job has risen dramatically and therefore households that do not receive any kind of income have also increased during the crisis. According

Figure 9: Average annual household income



Source: National Institute of Statistics. Survey of household budgets.

Figure 10: Development of inequality



Source: Eurostat Survey on Income and Living Conditions.

to the social NGO Caritas,[13] in 2011 3.2 per cent of total households did not have any income. In 2007, this was 2.1 per cent.

5.2 Economic Inequality

This decline in the average annual income per household is further aggravated by rising inequality. Spain has seen one of the highest increases in inequality in the European Union. While the average EU Gini coefficient was 30.6 in 2007 and 30.7 in 2011, in Spain the Gini coefficient rose from 31.3 to 34.0 in the same period.

The capacity of social policies to reverse this growing inequality during the crisis has increased. Taking the median income before pensions and social transfers and after social transfers, the capacity of social transfers to increase the median income has been substantial. While in real terms median income dropped by 14 per cent between 2007 and 2011, pensions and other social transfers allowed real disposable income to recover nearly 10 percentage points.

This redistributive capacity of social transfers has been essential to guarantee – or at least to mitigate – the effects of the crisis in inequality, but it has been highly concentrated in the pension system and other transfers have not been substantial enough to maintain the same level of income for the poorest 50 per cent of the population. This group has lost weight in the distribution of total disposable income since the beginning of the crisis: while before the crisis they had around 28.5 per cent of total disposable income, since the start of the crisis they

13. Caritas. Report on Social Exclusion and Social development in Spain 2012, Exclusión y Desarrollo Social. Análisis y perspectivas 2012.

have lost 2 percentage points, which were gained by the richest half, whose share rose from 71.5 per cent in 2008 to 73.5 per cent in 2011.

As the Spanish Economic and Social Committee stated in its report on income distribution, apart from transfers, the most redistributive policies over the long term were education and health care, which have suffered strong adjustment in recent years.[14]

Social inequality in Spain has traditionally been increased during periods of economic crisis, but inequality has not been reduced during periods of economic expansion, even during the long expansionary period between 1995 and 2007.[15]

5.3 Increase in Poverty and Exclusion

Lower total disposable income and a higher level of inequality have led directly to a dramatic increase in poverty and social exclusion. According to the EU's definition, in Spain the proportion of people at risk of exclusion in 2012 was 28.2 per cent, 3.7 percentage points higher than before the crisis.

Behind this general figure, there are specific developments for different social groups. By age, the group most affected by poverty is children (below 16 years of age), who accounted for 29.7 per cent of the population at risk of poverty. Girls below 16 years of age are the most affected group, with 30.5 per cent at risk of poverty. Paradoxically, the social group with the lowest level of risk of poverty are those above 65 years of age. Before the crisis, they were the group with the highest poverty rate, but the economic crisis and the subsequent support for pensions have changed the pattern of Spanish poverty.

While economic activity and other social benefits have declined, pensions have been relatively well protected. Old people are the only social group whose average income has grown in nominal terms.[16] As a result, old people are increasing their support for the younger generation. In 2010, 20 per cent of old people declared they were helping their families economically. This percentage increased in 2012 to 30 per cent and in 2013 to 40.3 per cent.[17]

On the other hand, the situation of child poverty is becoming dramatic. According to Eurostat,[18] households with dependent children have a poverty risk rate (24.8 per cent) higher than those with no children (18.5 per cent) and 44.8 per cent of households with a single parent and dependent children are in situation of social exclusion or poverty. There are more poor households and they are poorer than in the past: in 2011, 12.7 per cent of total households with dependent children received less than 4,772 euros a year, which represents 40 per cent of median disposable income; the figure was 8.7 per cent in 2008.

According to UNICEF, between 2007 and 2010 households with children in which all the adults are unemployed grew by 120 per cent. The educational level of the parents is very important in determining the poverty rate of children. The poverty rate among children with parents with only primary or lower secondary education rose from 43.9 per cent in 2007 to 53.4 per cent in 2011.

Worsening economic conditions and budget cuts in social expenditure have led to this situation. Child poverty means less food and of poorer quality, changes in housing, poorer clothing, not enough space at home to study or play, not being able to pay for daily school meals and less or no extra educational spending.[19] Furthermore, low social expenditure on children can make it difficult for mothers to participate in the labour market.[20]

Household conditions are also very important in understanding early school drop-out and future poverty rates. According to some studies, 29 per cent of young people from families in which the parents have only a primary education are so-called NEETs (not in employment, edu-

14. Economic and Social Committee, Distribución de la Renta en España: Desigualdad, cambios estructurales y ciclos, Report 03/2013.

15. Economic and Social Committee, Distribución de la Renta en España: Desigualdad, cambios estructurales y ciclos, Report 03/2013.

16. Eurostat 2012.

17. As a percentage of those interviewed who declared they were giving economic support to their families in different surveys: IMSERSO, Old People Barometer 2010; Red Cross Report on Social Vulnerability 2012; Democratic Union of Pensioners and Retired People Barometer on the Solidarity of Old People, 2013.

18. Eurostat Statistics on Income and Living Conditions (EU-SILC) 2012.

19. UNICEF 2012. Report, La Infancia en España 2012–2013.

20. Navarro and Clua-Losada, El impacto de la crisis en las familias y la infancia, Ariel 2012.

cation or training).[21] Poverty rates of people between 25 and 29 years old are also strongly determined by the educational level of the parents. The poverty rate among young people with parents with only a primary education was 20.3 per cent in 2011, while the poverty rate of those with parents with a university education was 10.7 per cent.

As a result, the future development of the younger generation in Spain is in jeopardy. Among young people between 16 and 29 years of age, the NEET rate has increased from 12.2 per cent in 2007 to 18.8 per cent.

5.4 Conclusion: A More Fragmented Society

After this brief review of the social impact, we can draw the following conclusions:

- Since the start of the crisis, average and median real disposable incomes have declined in real terms, and the percentage of households with economic problems has increased.

- The decline in average disposable income has not affected everyone in the same way; the effect is concentrated in the poorest part of society, whose share of total income has fallen. Inequality has increased dramatically and social transfers have not been able to properly mitigate this effect. Redistributive effects have been concentrated in pensions.

- As a result, the total poverty rate has risen, concentrating its effects on single parent households, the unemployed and, especially, children. Paradoxically, and due to the relative resistance of the pension system and its redistributive effects, people above 65 years of age have relatively reduced their rate of poverty during the crisis. Pensions, representing a guaranteed income, have played a key role in that.

- Child poverty is an extremely urgent issue. As their parents' lack of economic opportunities lead to a lack of vital opportunities for children – less health care, less access to good quality education – this can consolidate over the long term and obstruct future social mobility.

- Young people are also being hit by the crisis, especially those from less educated families. NEETs and youth poverty are concentrated in households with lower educational levels; as in the case of children, a lack of economic opportunities at this stage of their life will negatively affect their future performance as workers or even citizens.

6. Conclusion

The recent evolution of the Spanish economy has been strongly affected by the austerity policies recommended by the European Commission within the framework of the Stability and Growth Pact and its recent developments. While Spain has not been formally bailed out, it signed a Memorandum of Understanding in order to get funds to support its financial system in 2012. It is also under the surveillance of the Excessive Deficit Procedure and the other multilateral monitoring system established by EU economic governance.

The internal logic of this process has been summarized as »internal devaluation«, a process in which the country suffers wage devaluation in real terms, as macroeconomic stability is pursued by cutting public expenditure rather than by increasing public revenues. The aim is to gain competitiveness and increase exports, thereby raising production and employment.

As we have tried to show, internal devaluation is not only not achieving its macroeconomic targets, but it is also having a deep adverse impact on social conditions. Domestic demand has fallen and rising exports have not been enough to compensate. Labour market reforms have not managed to create new employment, but rather to reduce wage levels, changing the composition of income distribution between wages and profits, while unemployment continues to rise.

On the other hand, the social security role that the welfare state is supposed to play is being jeopardized by the fiscal austerity measures. While in the first part of the crisis, social expenditure rose to meet increasing social needs, since 2010 it has been cut and further reductions are expected in order to comply with the Stability Programme and the fiscal deficit targets.

21. Martinez Garcia, Estructura Social y desigualdad en España, Catarata 2013.

More specifically, public expenditure in health care, education, unemployment and social protection has declined since 2010, and the only budget line enjoying nominal growth is pensions. But even this nominal growth in pensions hides a much less positive evolution in real terms.

Worsening economic conditions, increasing unemployment and declining wages, together with the shrinkage of most social expenditure have led Spain into a very difficult social situation. Disposable income has decreased, poverty and income inequality have risen dramatically and the number of households in economic difficulties has increased. This is affecting the most vulnerable in particular. Child poverty has increased sharply.

While the effects of austerity on social cohesion have been devastating, it is also jeopardizing the capacity of the Spanish economy to achieve a higher level of growth in the future. Spain is losing the opportunity to modernize its social model and investment in human capital is not being increased. The risk of malnutrition and poverty among many children and the lack of investment in health care and education are posing a substantial threat to future economic and social performance.

As the Spanish economy needs urgent modernization, reforms must be accompanied by bold social policies that ensure social cohesion. If social cohesion continues to be damaged by austerity policies and fiscal consolidation, the social and political outcome of this process might undermine the basis of the Spanish democratic and social state.

If no policy change is implemented, Spain will spend many years recovering from the crisis.

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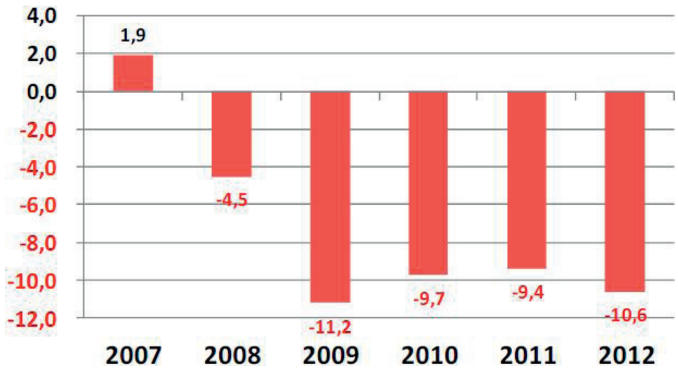
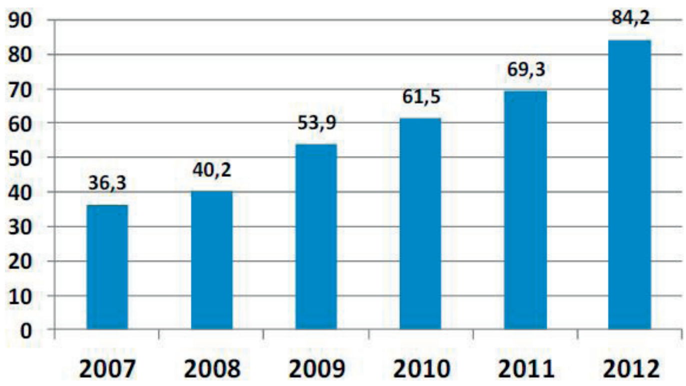
Appendix

Figure 11: Public deficit as a percentage of GDP



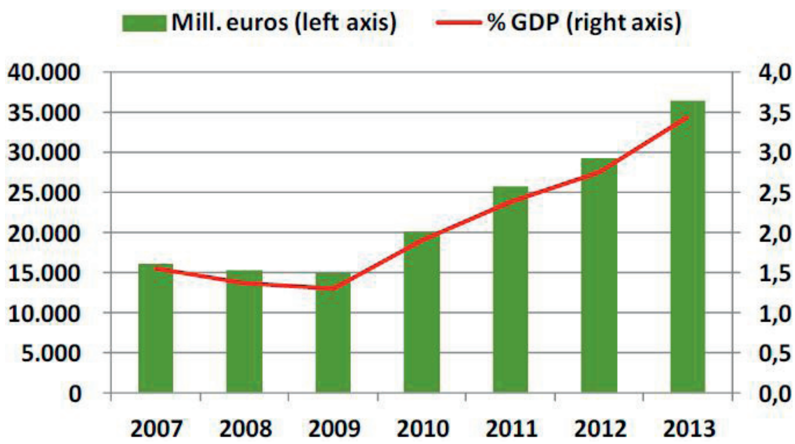
Source: Eurostat.

Figure 12: National debt as a percentage of GDP



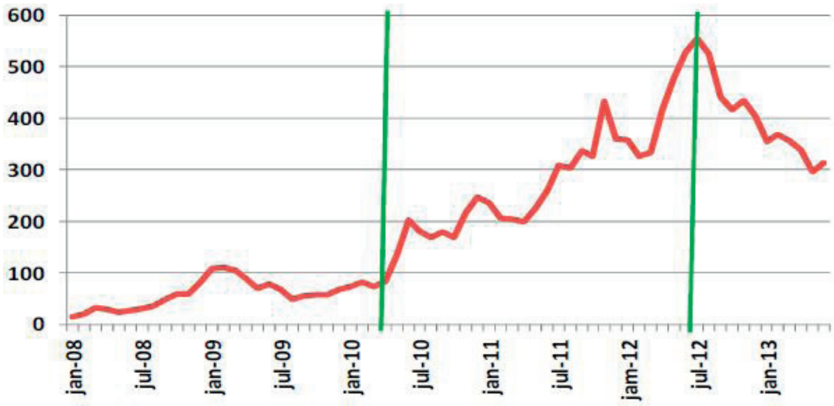
Source: Eurostat.

Figure 13: Public debt interest paid annually



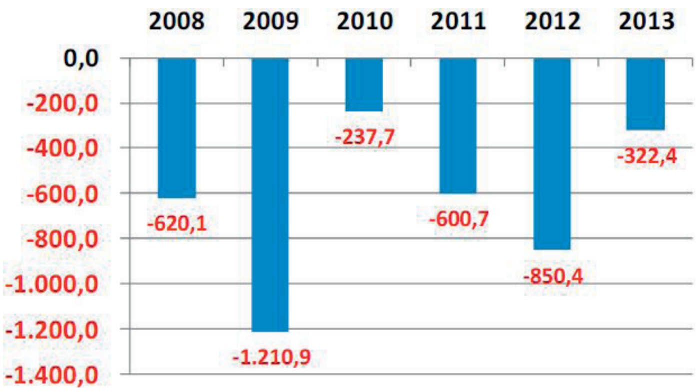
Source: Annual state budget. Ministry of Finance and Public Administration.

Figure 14: Risk premium: spread with German bonds (basis points)



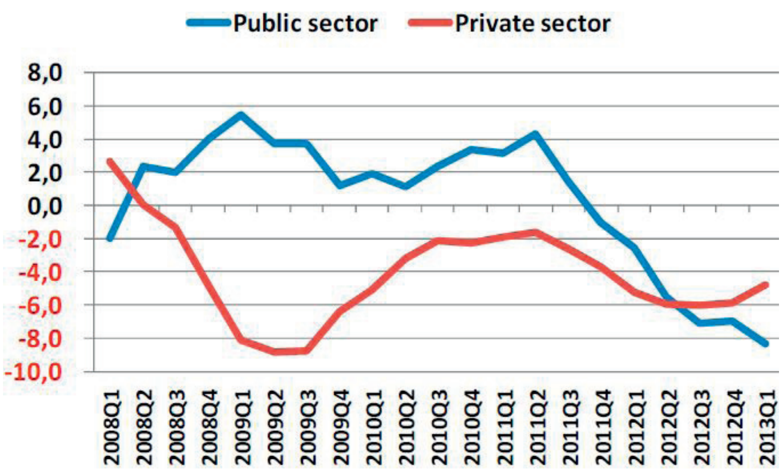
Source: Bank of Spain.

Figure 15: Employment destruction ('000)



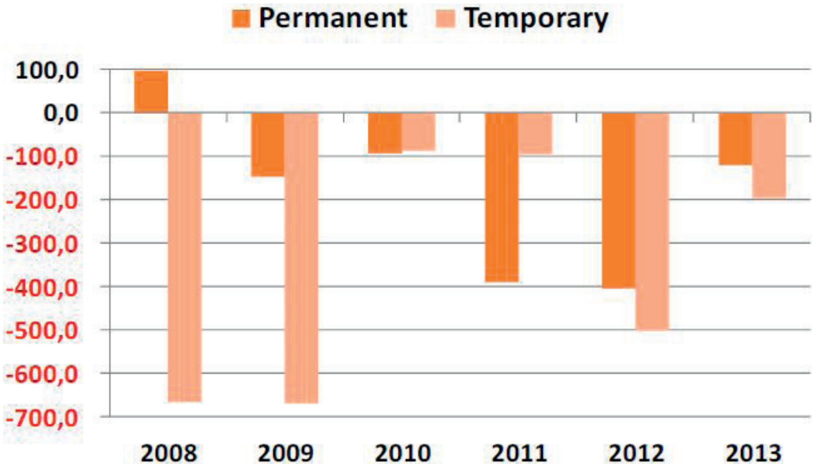
Note: Fourth quarter to fourth quarter, except 2013 (first quarter over quarter of 2012).
Source: National Labour Force Survey (EPA). INE.

Figure 16: Employment in public and private sector (annual growth rates)



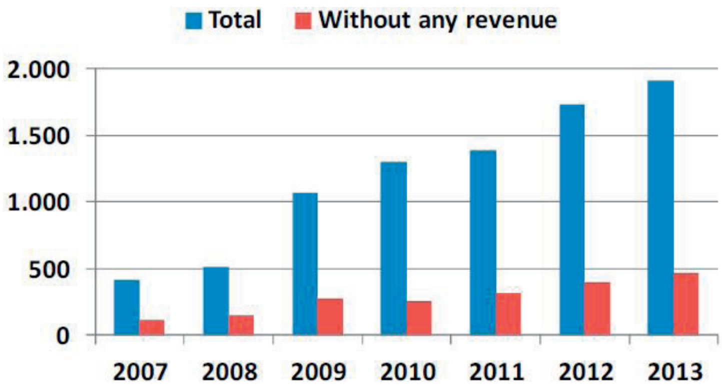
Source: National Labour Force Survey (EPA). INE.

Figure 17: Employees by type of contract (annual change in thousands)



Note: Fourth quarter to fourth quarter, except 2013 (first quarter over quarter of 2012).
Source: National Labour Force Survey (EPA). INE.

Figure 18: Households with all active members unemployed



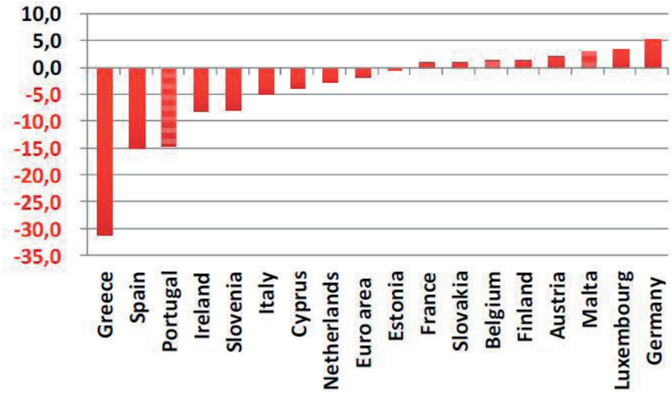
Note: First quarters of each year.
Source: National Labour Force Survey (EPA). INE.

Table 3: Nominal and real wage development (annual growth rates)

	2008	2009	2010	2011	2012
Wage increase in collective agreements	3,6	2,2	2,2	2,4	1,4
Wage costs	5,1	3,2	0,9	0,3	-0,5
Labour costs	4,8	3,5	0,4	1,2	-0,6
Inflation (ICP)	4,1	-0,3	1,8	3,2	2,4
Real wage increase in collective agreements	-0,5	2,5	0,4	-0,8	-0,9
Real wage costs	0,9	3,5	-0,8	-2,8	-2,9
Real labour costs	0,7	3,8	-1,4	-2,0	-2,9

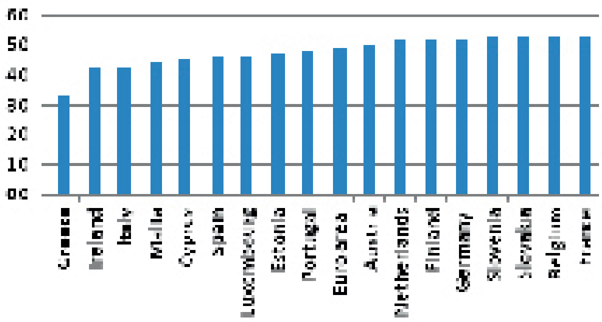
Source: Compiled from Ministry of Employment and Social Security and Quarterly Labour Cost Survey (INE).

Figure 19: Real compensation of employees, 2010–2012 (cumulative percentage growth rates)



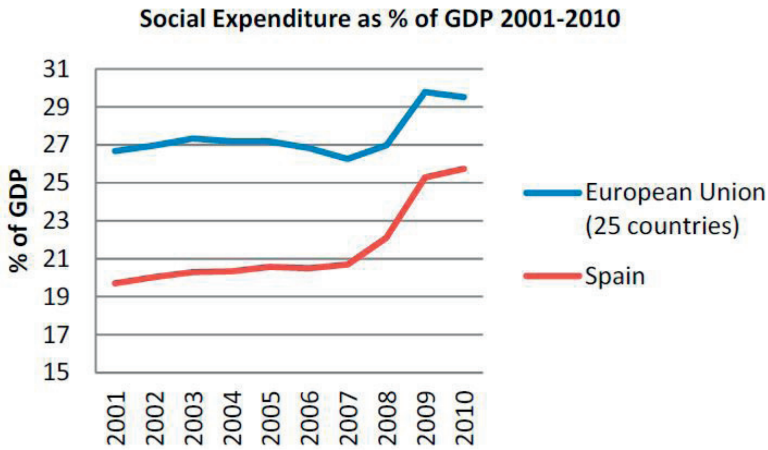
Source: Compiled from Eurostat.

Figure 20: Wages (2012) as a percentage of GDP



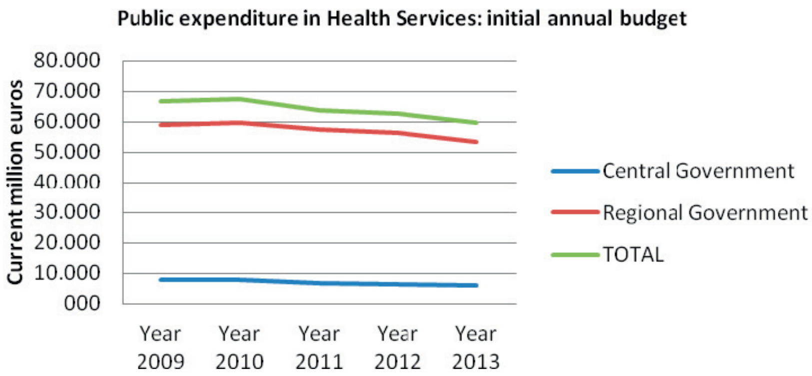
Source: Eurostat.

Figure 21: Social expenditure as a percentage of GDP, 2001–2010



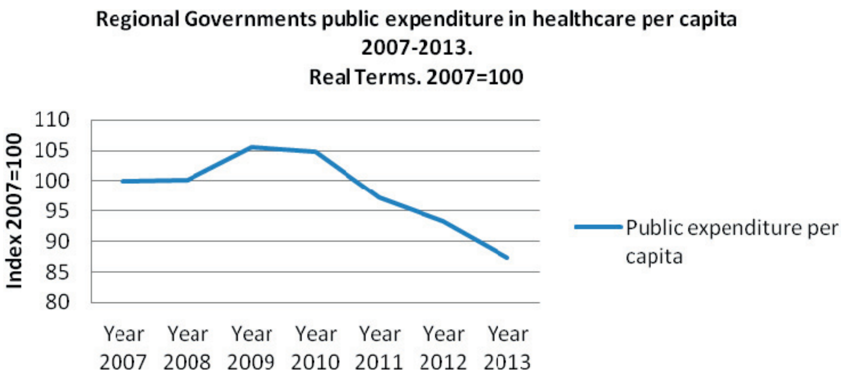
Source: Eurostat.

Figure 22: Public expenditure on health care, initial annual budget



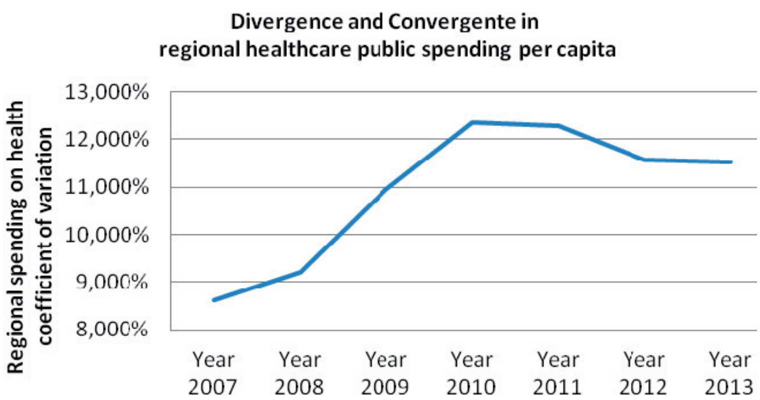
Source: Ministry of Health, Equity and Social Policy.

Figure 23: Regional government expenditure on health care per capita, 2007–2013 (real terms 2007 = 100)



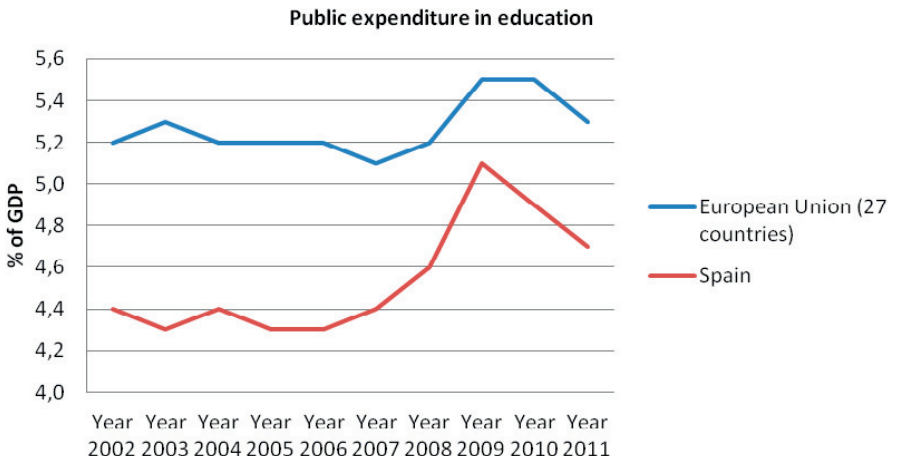
Source: Author's elaboration using data from Ministry of Health, Equity and Social Policy.

Figure 24: Divergence and convergence in regional health care spending per capita



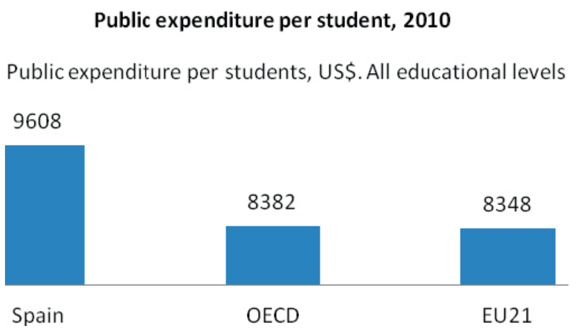
Source: Author's elaboration using data from Ministry of Health, Equity and Social Policy.

Figure 25: Public expenditure on education



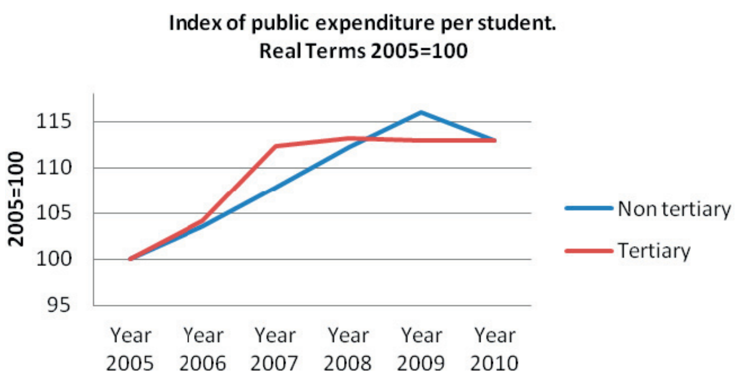
Source: Eurostat.

Figure 26: Public expenditure per student, 2010



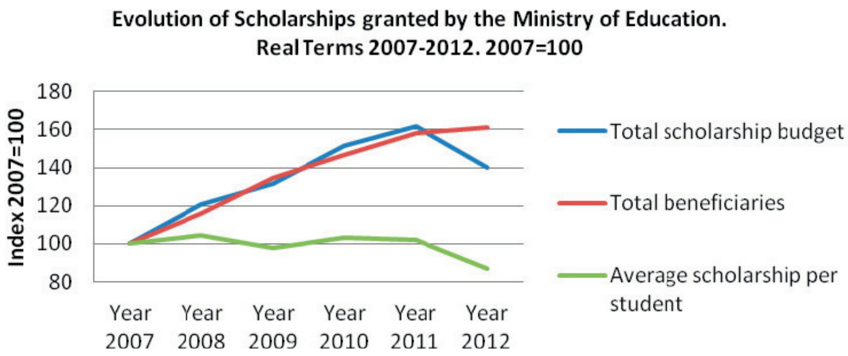
Source:OECD.

Figure 27: Index of public expenditure per student (real terms 2005 = 100)



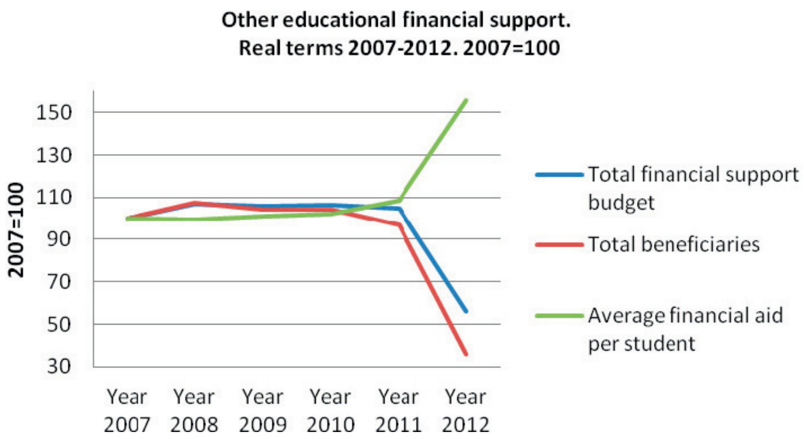
Source: OECD.

Figure 28: Evolution of scholarships granted by Ministry of Education (real terms 2007–2012, 2007=100)



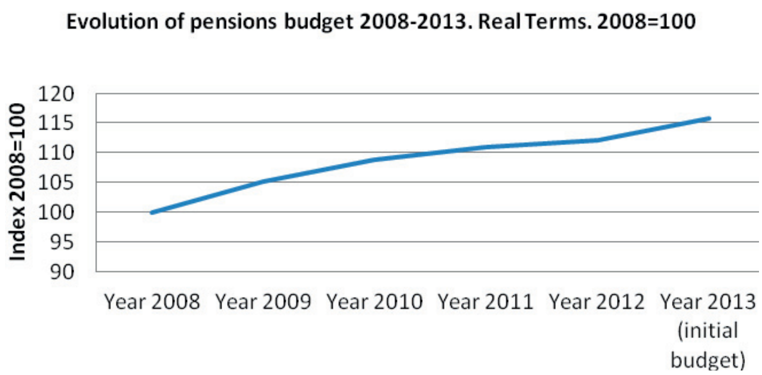
Source: Ministry of Education.

Figure 29: Other educational financial support (real terms 2007–2012; 2007=100)



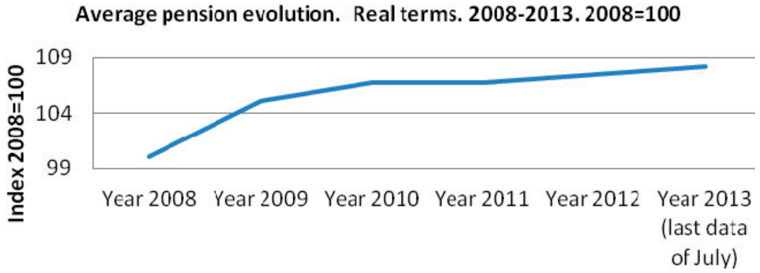
Source: Ministry of Education.

Figure 30: Evolution of pension budget, 2008–2013 (real terms 2008=100)



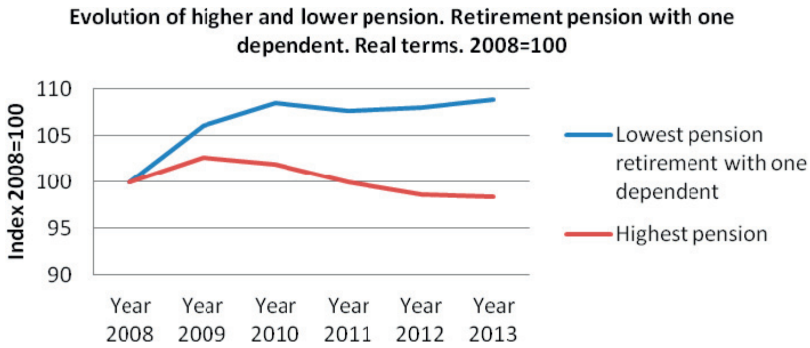
Source: Ministry of Social Security and Employment.

Figure 31: Development of average pension
(real terms 2008–2013; 2008=100)



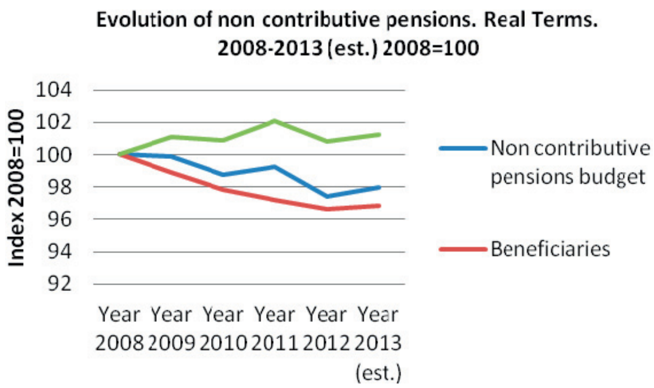
Source: Ministry of Social Security and Employment.

Figure 32: Evolution of higher and lower pension; retirement pension with one dependent (real terms 2008=100)



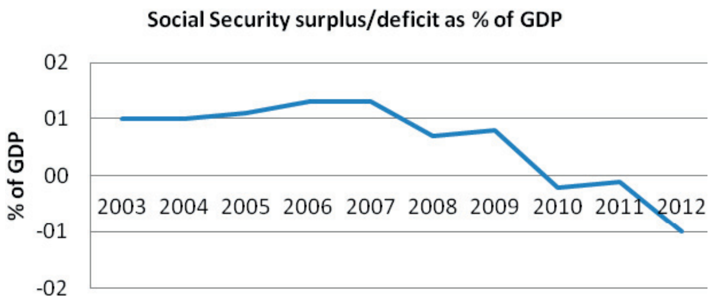
Source: Ministry of Social Security and Employment.

Figure 33: Evolution of non-contributory pensions
(real terms 2008–2013 est.; 2008=100)



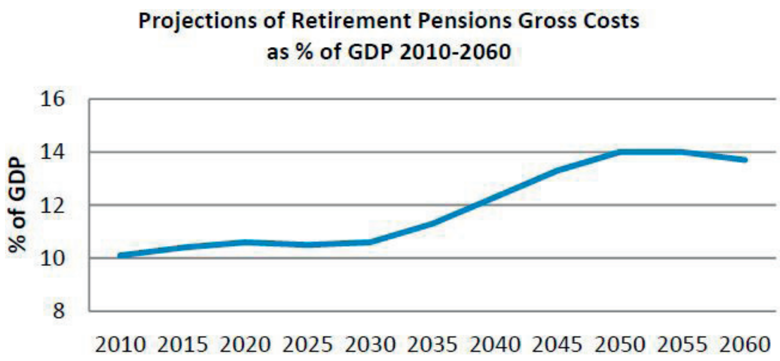
Source: Ministry of Social Security and Employment.

Figure 34: Social security surplus/deficit as a percentage of GDP



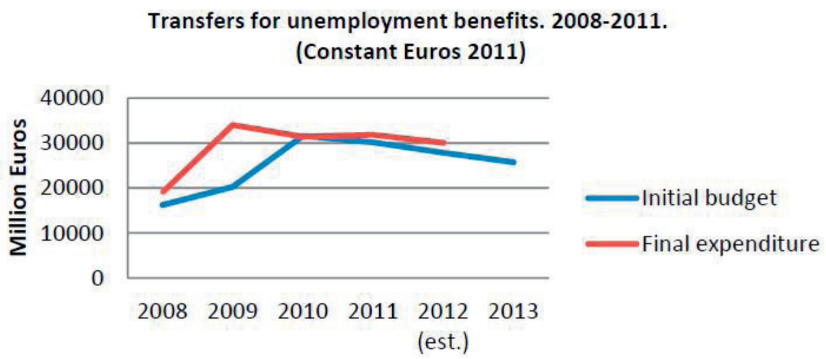
Source: Ministry of Social Security and Employment.

Figure 35: Projections of retirement pensions, gross costs as a percentage of GDP, 2010–2050



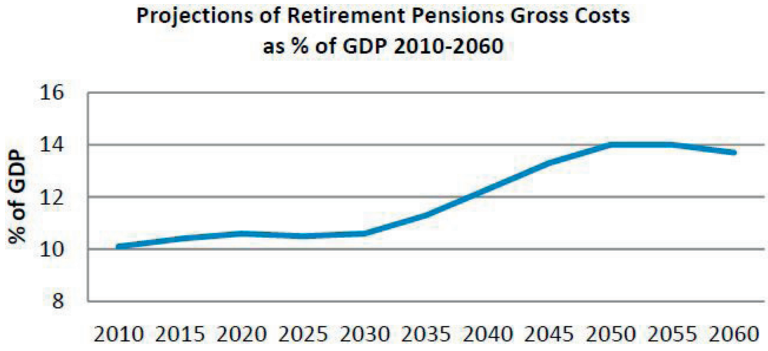
Source: European Commission.

Figure 36: Transfers for unemployment benefits, 2008–2011 (constant euros 2011)



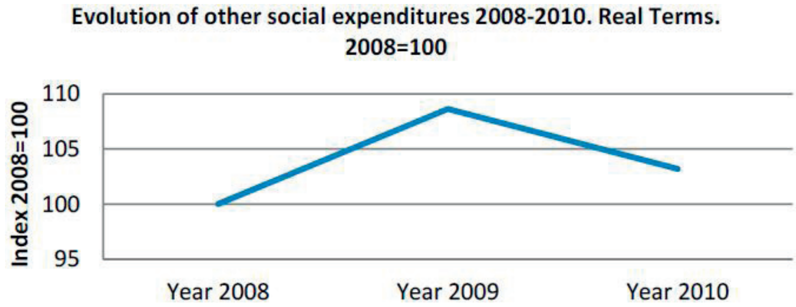
Source: Public Service of Employment.

Figure 37: Average unemployment benefit per day
(real terms 2008–2013; index 2008=100)



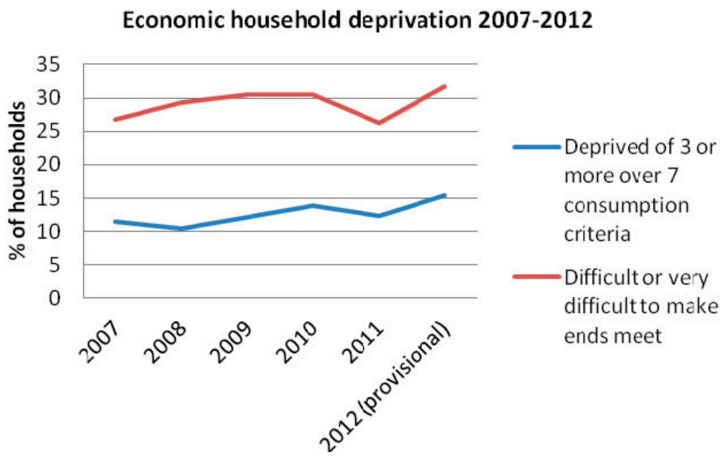
Source: Public Service of Employment.

Figure 38: Evolution of other social expenditure, 2008–2010
(real terms 2008=100)



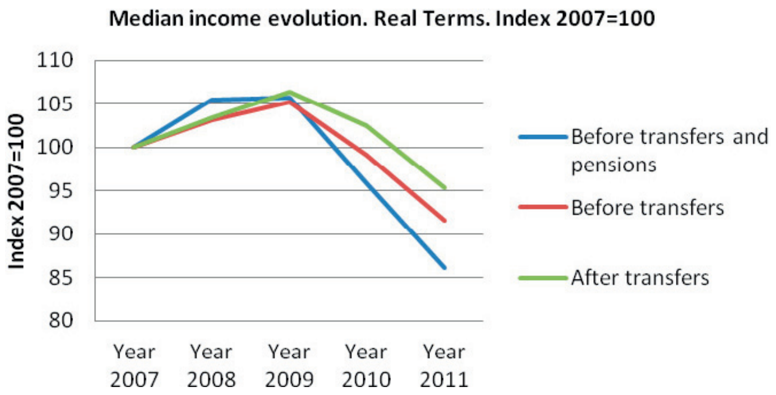
Source: Eurostat.

Figure 39: Household deprivation, 2007–2012



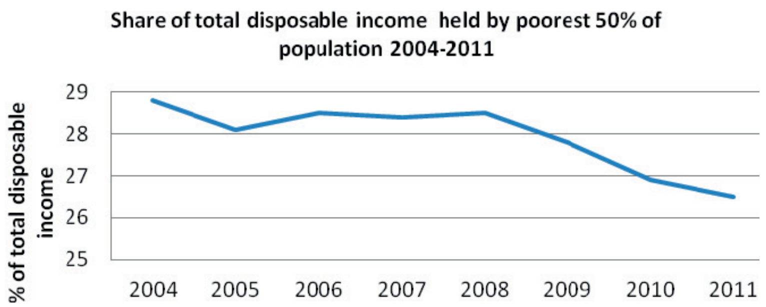
Source: National Institute of Statistics. Survey of Household Budgets.

Figure 40: Development of median income (real terms; index 2007=100)



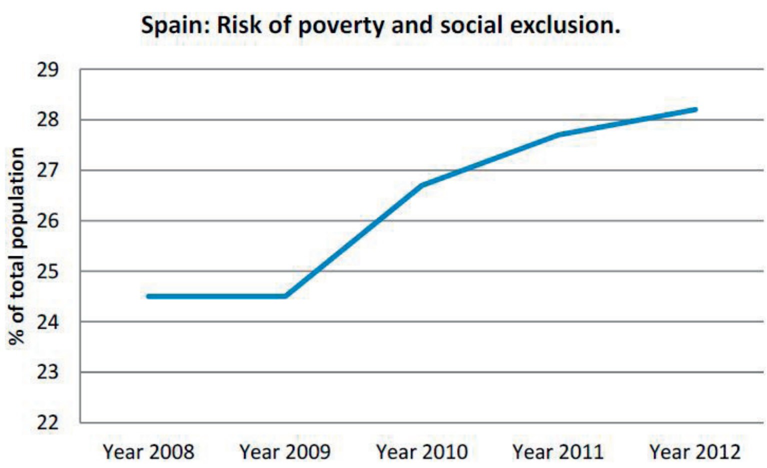
Source: Eurostat Survey on Income and Living Conditions.

Figure 41: Share of total disposable income of poorest 50 per cent of the population, 2004–2011



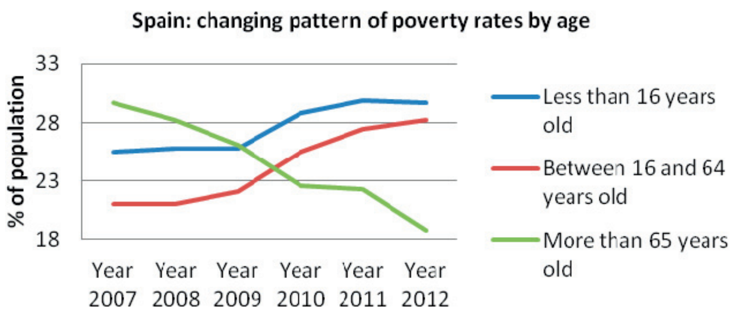
Source: Eurostat Survey on Income and Living Conditions.

Figure 42: Risk of poverty and social exclusion



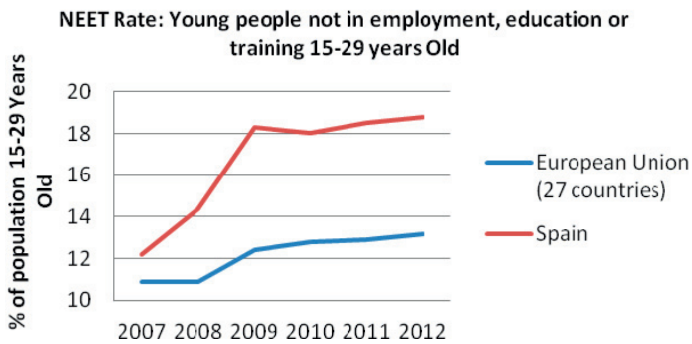
Source: Eurostat Survey on Income and Living Conditions.

Figure 43: Changing patterns of poverty rates by age



Source: Eurostat Survey on Income and Living Conditions.

Figure 44: NEET rate: young people not in employment, education or training, 15–29 years of age



Source: Eurostat Survey on Income and Living Conditions.

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