CRISIS, FISCAL CONSOLIDATION AND THE CUTBACKS IN THE WELFARE STATE IN SPAIN

by Rafael Muñoz de Bustillo, José-Ignacio Antón

The paper presents an account of the economic policy followed by Spain during the economic and financial crisis of 2009. After a first reaction based on the application of countercyclical policy, in 2010, following the directions and pressures of the European Commission and in a desperate intent to regain the confidence of the financial markets, the Spanish government made a U-turn in his economic policy embracing, with the faith of a convert, the doctrine of expansionary austerity and making the fight against public deficit its unique priority. This article reviews how this policy, jointly with labour market reform carried out at the same time, has affected the relative weak Spanish Welfare State.

Il saggio fornisce un resoconto della politica economica adottata dalla Spagna durante la crisi economica e finanziaria del 2009. Dopo una reazione iniziale fondata sull'attuazione di politiche anticicliche, nel 2010, in seguito alle indicazioni e alle pressioni provenienti dalla Commissione europea, e nel disperato tentativo di riconquistare la fiducia dei mercati finanziari, il governo spagnolo ha invertito radicalmente la rotta della propria politica economica, adottando, con la fiducia tipica del neofita, la dottrina dell'austerità espansiva, e facendo della lotta contro il deficit pubblico la sua unica priorità. Il presente articolo analizza come questa politica, insieme alla riforma del mercato del lavoro portata avanti in contemporanea, ha colpito il relativamente debole Stato sociale spagnolo.

1. Introduction

The growth of the Spanish economy in terms of both employment and GDP in the decade prior to the crisis can be considered, by all means, as extraordinary (FIG. 1). In a decade and a half, Spain was able to catch up with the core countries of the European Union (EU), reducing by 2008 its distance with the EU-15 GDP per capita to five percentage points[1]. From 1992 to 2007, the growth experienced by employed population in Spain (from 12 to 20 million) amounted to 31% of total employment growth in the EU-15[2]. Although before the crisis the Spanish unemployment rate was still high for EU standards, the labour market managed to absorb more than four million of foreign workers in little more than a decade.

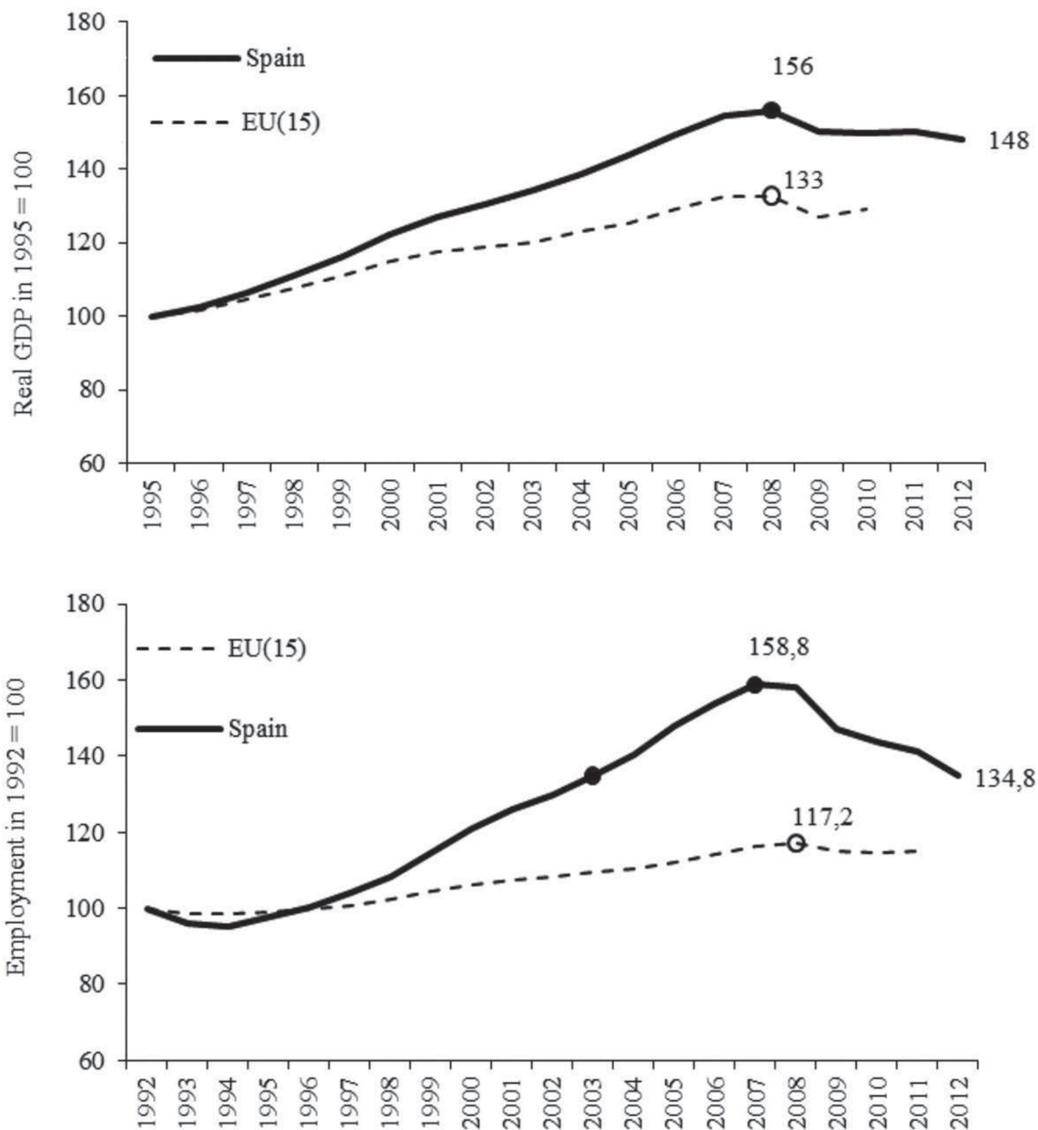
Rafael Muñoz de Bustillo and José-Ignacio Antón, University of Salamanca.

[1] In 2007, Spain made *il sorpasso* of the Italian economy in terms of GDP per capita, an event much hailed by the Spanish government and mass media (Ana Carbajosa ans Serafí del Arco, *España supera por primera vez a Italia en riqueza por habitante*, "El País", December 18, 2007).

[2] In contrast, in 1992 Spanish employment was barely 8.5% of total EU-15 employment.

This paper presents an account of the macroeconomic policy followed in Spain during the crisis and its implication for the performance of the Spanish economy and the future of the Welfare State. With that aim, section 2 reviews the different stages of the crisis focusing on the economic policies adopted. In section 3, we present an account of the effects of the policies on the Spanish Welfare State. Finally, section 4 summarizes the major conclusions of the analysis.

Figure 1. Real GDP and employment growth in the EU and Spain (1992-2012)



Source: Authors' analysis from Eurostat data and Spanish Labour Force Survey.

2. From "crisis, what crisis?" to the big U-turn

Before the crisis hit the Spanish economy, the situation of the country in terms of macroeconomic equilibria was different depending on the item observed. In terms of

public finances, the situation was quite healthy. Although the crisis of 1993 left the country with an all-time high public deficit of –7.2% in 1995, the process of fiscal consolidation followed to meet the Maastricht criteria and the high rate of economic growth (relative to other developed countries) made possible reaching the equilibrium of public accounts by 2004 and a surplus of 2.4% of GDP by 2006. In contrast, the current account showed a huge imbalance of as much as -10% of GDP in 2007. Foreign trade has always been the Achilles' heel of the Spanish economy and growth periods have traditionally ended in a foreign sector crisis. The difference this time is that, while in other periods, like 1986-1993, the crisis erupted when the current account deficit reached around 4% of GDP, this time, due to the creation of the European Monetary Union, with what at the time seemed like an unlimited perpetual supply of credit (in no small portion supplied by banks in rich but stagnant economies such as Germany), the disequilibrium kept on growing. The other side of the increase in external deficit was a huge accumulation of private debt, largely fuelled by a construction boom.

Although these developments were largely evident (for example, from 1997 to 2007 housing prices doubled in real terms[3], and the participation of construction in GDP rose from 6.5% in 1997 to 10.6% ten years later), most economists and government officials argued that the Spanish economy was on solid ground, even when the first stages of the crisis started to unravel. For example, asked about the risk of a drop in housing prices and the potential negative implication of such event on over-indebted home owners and the economy, the Director of the Research Department of the Spanish Central Bank (*Banco de España*), Mr. Malo de Molina, declared in 2007: «We have never talked about a housing bubble, neither we expect any other thing but a soft deceleration of prices» (*El Diario Montañés*, December 14, 2007). Few months later, Ángel Gurría, Secretary General of the Organisation for Economic Co-operation and Development (OECD), declared that in Spain the «housing "boom" is turning into a landing much softer that in other places because there was no speculative bubble […] "Chapeau" for the Spanish financial system, that thanks to the competent and serious work of the regulatory authorities […] seems to be doing better than in other cases» (www.elcorreodigital.com, March 16, 2008)[4].

2008 was an election year in Spain, and the Spanish Socialist Workers Party (PSOE in its Spanish acronym), validated its mandate in the ballot box. Although this year, considered as a whole, featured positive growth, by December it was clear than Spain was doomed to join the rest of the western countries in recession. The IBEX-35 (the Spanish stock and exchange index) lost almost 40% of its value and the unemployment rate rose from 8% to 14% in one year. During the political campaign the first symptoms of what at the moment was considered a "deceleration" of the economy were acknowledged, although certainly not with any sense of urgency. For example, no other than the Minister of Economy, Pedro Solbes, said in the Parliament in January 2008 «we should not expect a major change of the situation» (Comisión de Economía del Congreso, January 10, 2008). In this context, one of the wild cards of the President of Government, the Social-Democrat José Luis Rodríguez

[3] Increase in price of new housing according to the Spanish Property Valuation Society and deflacted by Consumer Price Index from the National Statistics Institute.

[4] The misinterpretation of the events taking place in the economy was by no means circumscribed to Spain. As late as September 19, 2007, the winner of the Nobel Prize of Economics, Robert Lucas, stated in "The Wall Street Journal": «I am skeptical about the argument that the subprime mortgage problem will contaminate the whole mortgage market, that housing construction will come to a halt, and that the economy will slip into a recession. […]. If we have learned anything from the past 20 years it is that there is a lot of stability built into the real economy» (quoted in Knibbe, 2013, p. 63).

Zapatero was a general tax rebate of €400 (similar to the US $600 Bush rebate included in the Economic Stimulus Act of February 2008) aimed, according to the President, at «stimulating the economy». By April, the Minister was confident that the «economy would start to improve at the end of 2009», considering that the crisis of the early 1990 was «much more deep that the current» ("El País", April 20, 2008). Unfortunately, the facts were stubborn and by July 2008 the President recognized the economic crisis announcing he would take the necessary steps to confront it[5]. The economic policy adopted was based on three pillars: 1. allowing the free working of the automatic stabilisers through lower taxes and higher social transfers, mostly unemployment benefits, 2. *ad hoc* tax reductions, 3. an *ad hoc* expenditure program (the so called *Plan-E*) aimed at building new infrastructures.

Little is to be said about the first item but that in the previous crisis, in 1993, the requirements for unemployment benefits were tighten up in order to reduce expenditure, reducing the stabilization power of the automatic stabilizer par excellence. This time the reaction was the opposite one, creating a new flat-rate assistance program for those unemployed (under tight conditions) after they used up the standard unemployment benefits[6].

In relation to the *ad hoc* tax cuts, the main measure – 73% of all tax reductions (Uxó *et al*., 2010) – was the mentioned income tax rebate, with a cost of €6 billion, around 1/4 of fiscal surplus of 2008[7]. This proposal had a clear electoral intention and is the measure of economic policy less justified from the perspective of countercyclical policy. It is well known than fiscal stimuli through tax reductions are less powerful than those based in increase in expenditure, as part of the stimulus goes into savings.

The *Plan E* (Spanish Plan to Boost the Economy and Employment) consisted in a long list of interventions, among them the more Keynesian in nature where the creation of two different funds, with a total budget of 11 billion Euro, aimed at increasing public investments at the local level by financing newly planned public works to be implemented in 2009 (73% of budget) and immediate actions in specific, strategic, production sectors[8]. These measures meant an important fiscal stimulus in 2008, the largest in the EU, but were sort lived, as in 2010 the size of the stimulus package was cut by three fourths.

These interventions were backed by the European Commission that in the last months of 2008 presented the *European Economic Recovery Plan* with the intention of compensating the drop of effective demand by means of «a counter-cyclical macro-economic response to the crisis in the form of an ambitious set of actions to support the real economy» (p. 6), including an immediate budgetary impulse of 1.5% of EU GDP (80% made up of a budgetary expansion by Member States, the rest by funding in support of immediate actions by EU) (European Commission, 2008a). In other documents, though, the position of the Commission in relation to countercyclical expansive policies is clearly less enthusiastic: «reforms supporting demand in the short run should be timely, targeted and temporary» (p. 5) (European Commission, 2008b).

Looking at figure 2, that reproduces the evolution of GDP during the crisis, we could say that the first reaction to the crisis through the development of compensatory

[5] "El País", *Zapatero menciona por primera vez la palabra crisis para referirse a la situación económica*, July 8, 2008.

[6] The program (*Plan PREPARA*) allows for a flat benefit of €400 during six months. Since its creation in 2009 the program has been extended, first, under the socialist government and, then, by the conservative government. In 2010, a quarter of a million persons benefited from this program. The number of beneficiaries has decreased considerably since then.

[7] The other major measure on the income side was the phasing out of the wealth tax (€1.8 billion).

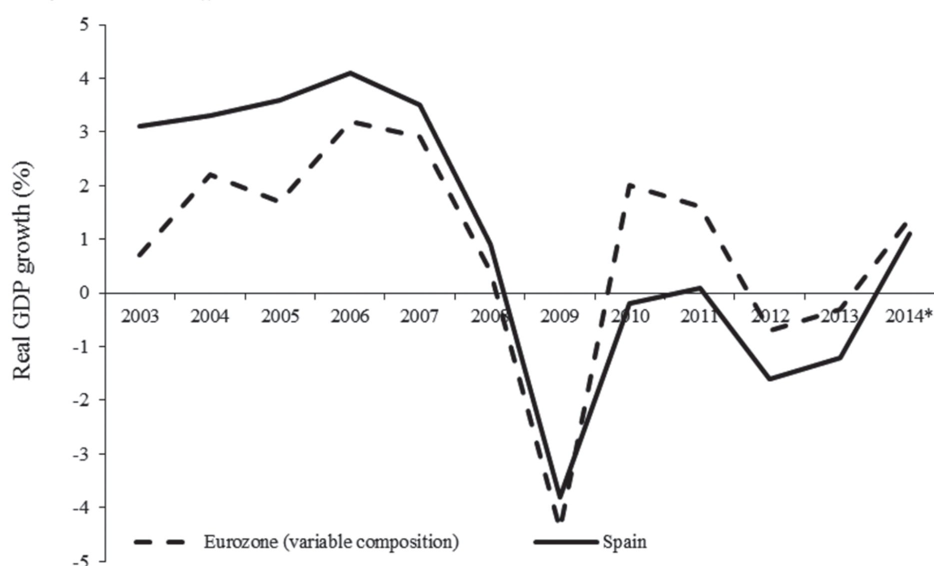
[8] For more details of the *Plan E*, see Uxó *et al*. (2010) and Muñoz de Bustillo, Antón (2013).

increases in public sector demand had the expected (Keynesian) impact on GDP. After the unprecedented, since the Great Depression, drop in GDP of 2009, the economy bounced back in 2010. This fast recovery led many influential voices of the economic arena to urge for a change in economic policy, placing fiscal consolidation in the forefront of the priorities. For example the OECD in his influential *Economic Outlook* of May 2010 argued that «where the process has not already begun, consolidation of the public finances should start by next year at the latest» (OECD, 2010, p. 47). Few months earlier the ECFIN declared that «There is a need for timely withdrawal of the fiscal stimulus. Provided that the Commission forecasts continue to indicate that the recovery is strengthening and becoming self-sustaining, fiscal consolidation in all EU Member States should start in 2011 at the latest»[9].

But that view was clearly not shared by all observers. By the end of 2010 there were many authoritative voices that advised of the growing risk of entering in a double dip recession.[10] In 2011, a study carried out by Ernst and Young (2011) based on in depth interviews to more than one hundred public sector analysts in 15 countries, concluded that the main risk faced by the economy was to enter in a double dip recession as a result of the policy of fiscal consolidation. The same conclusion is reached in the UN *World Economic Situation and Prospects* as of mid-2012. Unfortunately, such fears have been proved not to be farfetched.

The recovery of the economy made possible by the countercyclical policy was accompanied by a very rapid recovery of the stock market. While from May 2008 to March 2009 the IBEX 35 (the index of the Spanish *Bolsa* -stock and exchange market) felt by 50% (from 14,000 to 6,817) by January 2010 the index had climbed back to the 12,000 level. Such optimism, at odds with a situation of economic stagnation and high unemployment (20%), was short lived as few months later the Spanish stock and exchange suffered a major setback, loosing almost one fourth of its value.

Figure 2. GDP growth in Spain and the Euro zone (2003-14)



* Forecast.
Source: Authors' analysis from Eurostat and National Statistics Institute data.

[9] 2967th Council meeting. Economic and Financial Affairs, Luxembourg, October 20, 2009.

[10] See, for example, J. Kollewe, *Double-dip recession fears rise among chief financial officers*, "The Guardian" (October 10, 2010), or R.Schiller, *Fear of a Double Dip Could Cause One*, "The New York Times" (May 15, 2010).

The downside of the resolute (although sometimes misguided, as in the income tax rebate case) countercyclical policy followed by the Spanish government was a quick deterioration of the public sector fiscal balance. Before the crisis the Spanish public sector had what it looked like a healthy financial situation, with a surplus in 2006 of 2.4% of GDP, and falling public debt (36% of GDP in 2007)[11]. By 2009 the deficit had risen to –11.2%, the largest in the EU after Greece, Ireland and the UK, while debt crossed the 60% Maastricht threshold.

The deterioration of public finances and the pusillanimous behaviour of the European Central Bank *vis-à-vis* other monetary institutions such as the American Federal Reserve, in relation to its role in defending the financial stability of the Eurozone countries, led to an increase in the cost of financing of sovereign bonds in all the countries with higher financial needs, exacerbating the cost of public debt financing and making more difficult for a group of highly indebted countries with stagnant economies, in a self-fulfilling prophecy, to refinance their public debt. Some qualified analysts saw this phenomenon and the recent decline in risk premium as not driven by economic fundamentals but by panics and herd behaviours (De Grauwe, 2011; De Grauwe, Ji, 2013, 2014).

The high overall debt, the growing problems of Spanish banks to met their capital requirements in a context of falling housing prices, the virtual disappearance of the interbank credit market and increasing private default rates, together with the still high foreign deficit and the gargantuan unemployment rate made Spain a perfect candidate for a financial flight and deposit run. By May 2010 the EU Member States finally agreed to develop a contingency fund to aid the countries cut off from access to financial markets, asking in return for a resolute policy of deficit reduction by the countries at risk. This event marked a turning point in the economic policy pursued by the Spanish government. From that moment on and until today, the major obsession of the government, both the Socialist cabinet, after its conversion in May 2010 to the "true faith" of fiscal consolidation, and the conservative government that took office at the end of 2011, has been to reduce public deficit regardless of its consequences.

The big U-turn of Spanish macroeconomic policy in 2010 is clear by looking at the evolution of public revenue, expenditure and fiscal balance before and after 2010. In a context of growing unemployment and sluggish growth in foreign demand the relation between the change of economic policy – represented in figure 3 – and the return to recession – depicted in figure 2 – is straightforward: the policy of fiscal consolidation was activated at a moment when public sector demand was the only component of effective demand capable of pulling the economy out of recession. The moment the public sector locomotive stalled, the economy entered again in recession. The policy of fiscal consolidation adopted halted the recovery leading to a double-dip recession, further deteriorating GDP and increasing the unemployment rate until it reached a stunning 26%.

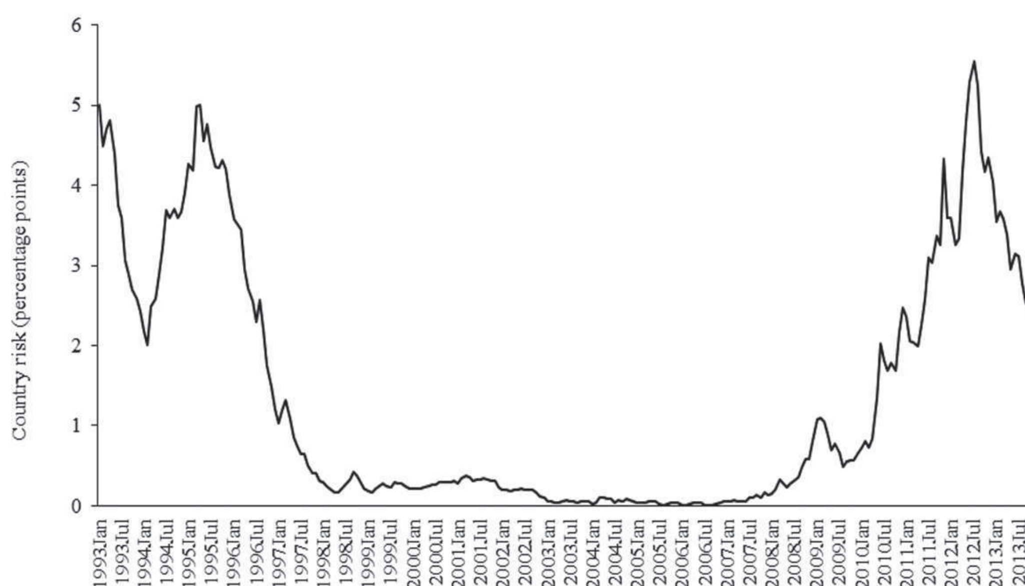
To what extent was this radical change of economic policy imposed by the economic situation and the dependency of Spain on the European Central Bank (ECB) and the EU?[12]

[11] To place these figures in context, the public deficit in "virtuous" Germany was –1.6%, and public debt amounted to 67% of GDP in 2006.

[12] Spain depends on the standard facilities of the ECB for the Spanish banks to get liquidity in a context of virtual freeze of the interbank lending market, on the announcements and actions of the ECB as buyer in the sovereign debt secondary markets to keep the interest rate paid by the Treasury within reasonable limits, on the EU funds to recapitalised its ailing banks (€39.5 billion obtained through the Emergency Financing Mechanism as of December 2012) and of the goodwill of the ECFIN and the European Commission at the moment of negotiating the process of reduction of public deficit towards the 3% GDP limit.

Although as mentioned above, the goal of fiscal consolidation has been ardently followed by both social-democrats and conservatives, there are few differences worth mentioning. As we have seen, at the onset of the crisis the position of the Socialist Party was clearly in favour of applying the standard Keynesian recipe. This approach was only altered, with regrets, by the events taking place on the secondary sovereign debt markets and the parallel pressure of the European Commission and the Economic and Financial Affairs Council (ECFIN). In the words of a member of President Rodríguez Zapatero's cabinet: «There were no alternatives. It had to be done and he did it with resolution»[13]. Nevertheless, after being forced to change policy, the government followed the new course of action with determination. In contrast, the conservative party (*Partido Popular*, PP), in power since the end of 2012, had a completely different interpretation of the crisis and the required policy to improve the economy. For the conservatives, from the beginning, the best way to fight the crisis was to reduce public deficit to avoid crowding out private investment. In a later stage, in the months previous to the elections, the conservatives also argued that deficit reduction was an imperative to regain the "confidence of the markets"[14]. As mentioned, the change in government did not lead to a major change in economic policy neither in terms of goals (after all the policy goals were fixed in Brussels and not in Madrid) nor in terms of instruments. The only difference was that the conservative party, after winning the elections by landslide (44.6% of the votes versus 28.7% of the Socialist Party), had the required (absolute) majority to apply their policies swiftly and without complexes or negotiations[15].

Figure 3. Risk premium of Spain (differential of interest rate between German and Spanish 10-year bonds, 1993-2013)



Source: Authors' analysis from European Central Bank, *Interest rate statistics. Long-term interest rate for convergence purpose*.

[13] José Manuel Romero, *Dos minutos que cambiaron a España*, "El País", May 16, 2010.

[14] Interestingly, during the last years of the social-democratic government the conservatives mastered the ability of combining their position as deficit hawks with their refusal to back on Parliament the expenditure cuts approved by the government.

[15] In any case, most of the policies followed (among them an increase in the Income Tax, an increase in the Value Added Tax or the increase in co-payments of medicines) were absent in the political manifesto of the Conservative Party for the 2012 elections, taking largely by surprise many of their supporters.

As the intention of the first measures of fiscal consolidation was to tame the secondary sovereign debt market and secure sufficient finance at a reasonable interest rate to finance the public deficit, we can use the evolution of the risk premium (measure by the difference in interest rates for bonds with 10 years maturity between Spain and Germany) to see to what extent the change of policies, first, and the change of government, later, were successful (FIG. 3). The answer is evident: the policy of fiscal consolidation and the change in government had little impact on the evolution of the premium (or country risk)[16].

3. Fiscal consolidation and the Spanish Welfare State

Although Spain shares many features with the rest of the EU-15 in terms of social policies, there are some peculiarities that are worth mentioning to provide the reader a better understanding of the trends, dynamics and changes experienced by the Spanish Social Model during the crisis:
1. late development. At the beginning of the 1960s, social spending was at very low levels (around 4% of the GDP) compared to other European economies such as Sweden, the United Kingdom, Italy, Belgium or Germany (where the Welfare State represented between 15 and 20% of the GDP)[17];
2. low social expenditure. In 2007, the year before the crisis started, social spending (including education expenditure) represented 25.3% of the GDP, compared to the EU-15 average 28.5%. As shown in figure 4, before the crisis, Spain had a lower social spending in all items of social policy (including education) but unemployment (due to the relative high Spanish unemployment rate) and survivors[18];
3. high degree of decentralization. Spanish Autonomous Regions are responsible of more than 41% of total social spending in the country. The participation of regions in the social area is almost unparalleled in developed countries, with only Switzerland (46%) and Canada (36%) reserving an important role for regional governments.

In sum, the Spanish Welfare State can be characterised as a low-profile Welfare State, with a reasonably funded National Health System and education scheme, accompanied by an unemployment and pension systems similar to those existing in Germany and France and a very residual role for family benefits and policies aimed to fight social exclusion, all of these elements combined in a highly decentralized administration.

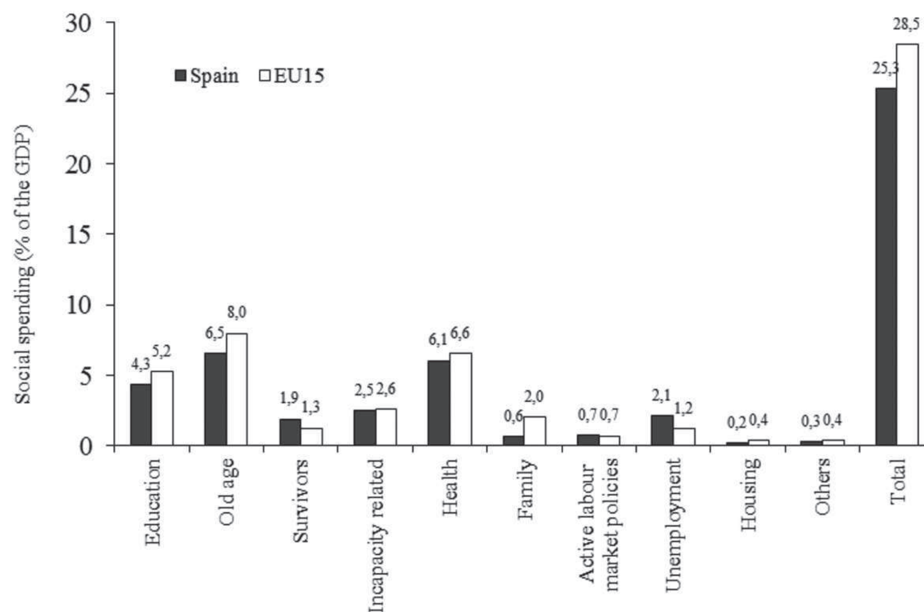
In relation to the Welfare State, the process of fiscal consolidation has unfolded in two stages. The first round of cuts relayed heavily in education and health (mostly through wages cuts and the freeze on new hiring of public sector employees). The second round focused on the pension system. In parallel, two different labour market reforms aimed at increasing the "flexibility" of the labour market, have greatly affected the system of collective bargaining and the power relations between firms and employees in favour of the former.

[16] In this line, De Grauwe and Ji (2014) argue that neither the previous panic that drove the sudden increase in risk premiums in the Southern European countries not the rapid decline the last months is propelled by economic fundamentals.

[17] See Muñoz de Bustillo and Antón (2014) for a summary of the building process of the Spanish Welfare State.

[18] In this case, the higher expenditure is probably related to the late incorporation of women into the labour market and the high dependency of women over 64 years old on their husbands' pensions.

Figure 4. Social spending in Spain compared to EU average (% of the GDP, 2007)



Source: Authors' analysis from OECD Statistics database.

3.1. Fiscal consolidation and the welfare state

The data of the evolution of public expenditure per capita by the levels of public administration – reproduced in table 1 – offer a clear idea of the budgetary impact of the process of fiscal consolidation and its allocation among the different social programs. In sum, two of the tiers of the Spanish Welfare State – education and health –, in hands of regional governments, have experienced significant cutbacks. The other two main programmes – namely, pensions and unemployment insurance – have not been affected in the same way. In fact, because of the demographic and labour market trends, overall spending on these policies has expanded from 2008 to 2013. The rest of benefits included in the social package – as mentioned, very modest – also experienced severe reductions.

Table 1. Change in real per capita public spending in Spain during the Great Recession

	Central government (2008-13)	Regional governments (2008-13)	Local governments (2008-12)
Total public spending	–1.7	–12.8	–18.7
Total social spending	–0.4	–15.9	–30.1
Health	–19.7	–14.4	–43.2
Education	–41.2	–16.6	–9.7
Social protection and housing	0.9	–19.3	–30.1
– Pension benefits	13.2		
– Unemployment benefits	32.5		

Note: regional figures are based on forecasted budgets. Central and local government figures were computed using budget execution up to 2011 and 2010.

Source: Authors' analysis from central, regional and local budgets and National Statistics Institute population estimations.

This reduction in expenditure has led to a decrease in public employment of nearly four hundred thousand workers (11.7% of total public employment at its highest level in 2011). Regarding remunerations, in 2010 a 10% a general reduction of wages of public employees of 5% was applied, while in 2012 the 14th pay (Christmas bonus) was temporarily removed. In the rest of the years, public wages and employment have been frozen and only 10% of vacancies associated to quits or retirements in the public sector have been covered in very specific areas (health, education, social services, tax administration and justice).

A detailed account of the cuts in social expenditure goes beyond the aims of this paper[19]. Instead, to give the reader a flavour, we focus here on the measures behind the reduction in health budgets. First, the central government, which is the responsible of regulating the basics of the decentralized health care system, has taken the following measures:

a) The increase of drug copayment for patients with income higher than €18,000 per year from 40 to 50 and 60% of prices depending on income level (although unemployed and people with low incomes are now exempted and the cost-sharing ratio depends on income), the extension of drug copayment to pensioners (up to 10% of prices with some exceptions and a monthly cap of €18) and the introduction of user fees in non-urgent medical transport services, prosthesis and wheelchairs and hospital drugs;

b) the removal of more than 400 medicaments attending minor symptoms (from cough to dermatitis) from the financed medicament list and limitations of in vitro fertilization to women with no children and aged less than 40 years old[20];

c) establishment of new requirements for foreign population to access public health services, *de facto* excluding illegal immigrants (who could access the National Health System since a reform carried out in 2000) from benefiting from any type of treatment excepting emergency care.

In second place, the central government, himself pressed by the European Commission, has put pressure on regional governments to reduce public spending and achieve fiscal consolidation. Given that education and health care are in hands of Autonomous Communities and represent roughly half of their budgets, this has translated in serious cutbacks on both social areas. Some regions have gone beyond central government guidelines and have imposed policy measures such as partial or total close down of primary health centres and hospitals, mainly – but not limited to – in rural and sparsely populated areas.

Although the impact of the bulk of the cutbacks is not likely to be observable until the next few years, there are some elements that, even on a preliminary basis, indicate that public health care provision is deteriorating in the short run. For instance, in terms of waiting lists, the declining trend observed since the data was made available to the general public has been reversed since December 2010, in coincidence with the austerity measures taken in the area. All together, the increase in work load of the health workers, if maintained in the medium and long run, could jeopardize the good results of Spanish National Health System. From a different perspective, the exclusion of groups of the population (notably, but not only, "illegal" immigrants) might set a dangerous precedent in terms of connecting the access to health care to growing requirements (instead of considering it from a human

[19] See, for example, Muñoz de Bustillo and Antón (2013, 2014) for details.

[20] There has been an important increase in the price of the medicines excluded, in some cases up to 100% which represents another example of unintended consequences of cuts in public expenditure.

rights perspective). The same can be said about the increase of copayments, that means making the sick people financial responsible of their condition.

The second wave of reforms has affected the pension system. In Spain, as well as in other EU countries, there has been an ongoing debate, sponsor among other by the ECFIN, about the sustainability of the public pension system faced with an increase in the demographic dependency ratio. Whatever the opinion one has about the need to reform the pension system, it is clear that the eventual problems faced by the pension system are of a long-run nature and unrelated to the current economic and financial crisis. In fact, during the first years of the crisis pensions, benefits kept aside of the cycles of the market, have acted as a first-class stabilizer. In any case, twice, and by governments of different political spectrum, the Spanish pension system has been reformed with urgency along the same lines though with different procedures. In the first, the reform was negotiated with the social partners (if at gun point), and among other changes, retirement age was postponed by two years (from 65 to 67 years old) at a pace of two months per year, the number of required years of work to reach the maximum pension was increased from 35 to 38 and the number of years used in the calculus of the pension was raised from the last 15 to the last 25[21]. While the first reform has been purely parametric (i.e. the nature of the system has not been affected, only some of the parameters used to determine the amount paid), two elements of the second reform, unilaterally approved by the conservative party in 2012, can be interpreted in terms of a fundamental change in one of the basic elements of the pension system: its reliability in terms of the size of the pension right. After the reform, workers will have less certainty about their pension's rights for two different reasons. In first place, a new so called sustainability factor, which consists in revising pension policy according to increases of life expectancy each 5 years, has been introduced. This is likely to imply additional reduction of benefits[22]. In the second place, while it was customary to index pensions to prices so pensioners maintained the purchasing power of their pensions in real terms during all their lives as pensioners, the reform of 2012 introduces a new formula that subordinate the pensions yearly increase to the financial situation of the Social Security, making possible for the authorities to increase pensions below CPI, with a floor as low as 0.25% (and a maximum increase of 1.25% of the CPI)[23]. In 2014, pensions rose by such minimum amount. This last change means that pensions are no longer protected against inflation, one of the main advantages of public pensions in comparison with private pensions, usually with no available mechanism of indexation at a reasonable cost.

3.2. Labour market reform

Together with the process of fiscal consolidation and Welfare State reform, the program of "structural reforms" carried by the government has heavily relied (and placed many expectations) in the reform of the labour market. Regardless of the impressive behaviour of the labour market, in terms of employment creation, during the boom years and the

[21] The impact of this last change is estimated to produce a decrease in the take home pension for new pensioners of 10% (Muñoz de Bustillo *et al.*, 2011).

[22] Due to pressures from the European Commission, the compromise of reviewing the need for such factor in 2027 included in the pension's reform of 2011 has been anticipated to 2012.

[23] In 2011 and 2012, contrarily to a wide political agreement among most of political parties forged in the middle 1990s that was translated into a law, pensions were adjusted below inflation. In 2011, benefits were frozen by the social-democratic government, with the exception of minimum pensions. In 2012, the conservatives raised 2% pensions below €1,000 per month and 1% the rest of pensions.

facility to get rid of surplus labour during the crisis, in both cases a sign of a highly flexible labour market, it has been considered that the huge increase in unemployment since the start of the crisis has to do with the rigidities of the labour market, partly due to a system of Collective Agreements that in times of economic downturn supposedly gives firms no alternative but firing their workers. Two different reforms were enacted in 2010 and 2012, respectively, in the same direction but by different governments (the first one, progressive and the second one, conservative) and with different levels of ambition (much more radical the second)[24]. In both cases, the aim was to facilitate "job creation, as well as the promotion of employment stability", by different actions, including the reduction of the level of employment protection of open-ended contracts, the promotion of part-time employment, fight against absenteeism and changes in collective bargaining. These reforms were preceded by a strong campaign against trade unions, pictured as something from the past and as an obstacle to progress and employment growth.

Before reviewing the axis of the reforms it is important to acknowledge the severity of the employment crisis in Spain and the role played in it by the extreme sensitivity of employment to changes in GDP: from 2008 to 2013, the drop in GDP was 7.6% while the decrease in employment almost reached 18%. A different question is whether such unemployment malaise is the results of a rigid labour market and uncompetitive wages. A recent paper by Díaz Sánchez and Varoudakis (2013) shows how the economic problems of the southern countries are more the legacy of North-South imbalance produced by the combination of financial integration, low interest rates and strong demand growth in the South, in a context of Northern stagnant economies, than the product of the lost of competitiveness in the periphery due to a wage growth higher than productivity growth. Unfortunately, the mainstream interpretation of the problems of the periphery emphasizes the role of inflexible labour markets and overpaid workers as the prime causes of the massive level of unemployment. Consequently, the policy adopted aims at increasing the leverage of firms *vis-à-vis* trade unions in setting the employment conditions and reducing wages in order the recompose profits, lower labour costs, increase competitiveness and solve the problems of balance of payments (the current account deficit reached 10% of GDP before the crisis).

In order to reach such outcome, the labour reform consisted in several elements: 1. lower severance payments, 2. reduction of employment protection of new open-ended contracts, 3. facilitation of the change of agreed working conditions include in collective agreements, 4. giving pre-eminence to enterprise level agreements over provincial, regional, sectorial or national agreements, 5. reduction of the period of applicability of collective agreements, CA, after its formal expiring date (before the reform the CA was valid until the signature of a new CA) to one year, 6. removal of the requisite of administrative authorization for collective dismissals (*Expedientes de Regulacion de Empleo*, ERE), which used to facilitate the negotiation of ERE between the firm and the workers representatives, 7. reduction of social benefits (sickness, days off, leaves, etc.) and increased working hours for public sector employees.

[24] The harshness of the second reform is exemplified by the transcribed conversation, held between Luis de Guindos (Spanish Minister of Economics and Competitiveness) and Olli Rehn (European Union Commissioner for Economic and Monetary Affairs), captured by an open microphone at a meeting of the Eurogroup in Brussels in April 9, 2012: «Tomorrow, we approve the reform of the labour market. You will see that it's going to be extremely, extremely aggressive, you know, with large flexibility in the collective settlement of agreements and we reduce severance payments. Well, you will see, you will see […]».

After one year of the enactment of the reform, is still too early to have evidence of its implications. Much more so if we consider that the existing humongous reserve of unemployed workers, 5.9 million workers the first quarter of 2014, is likely to exert a major negative impact on the quality of work and employment. Such effect would be difficult to disentangle from the effect of the reform itself. In any case, and with the necessary cautions, the following provisional conclusions about the short term impact of the above mentioned reforms can be outlined:

1. in 2013, as in all the years since the beginning of the crisis, the destruction of employment has been much more intense than the fall in GDP. In this respect Spain shows a very high elasticity of employment to GDP – for 2013 was 2.46 (similar to the value of 2012, 2.33), that the reform, as pretended, has not been able to reduce;
2. social dialogue has been a collateral victim (and often the target) of this policy of labour market liberalization. In sharp contrast to previous reforms, the changes passed during the crisis were made while sidelining the social partners, especially trade unions. Both reforms have been confronted by Spanish trade unions with two general strikes (on September 29, 2010 and March 29, 2012) and numerous protests and demonstrations. In fact, in 2012, there were 3,419 demonstrations in Madrid, more than twice the number of demonstrations held in the city two years earlier;
3. postponement of collective bargaining (less incentives for firms to promptly negotiate agrements);
4. increase of the number of firms opting out of CA. In most cases, the inapplicability of CA is related to wages;
5. reduction in the number of collective agreements with automatic revision of wages according to inflation (indexation), from around 2/3 before the crisis to less than 1/3 in 2013;
6. reduction in temporary absences due to sickness from 30 (per 1,000 workers) before the crisis to 18 in 2013 and the duration of the absence for private sector employees[25]. This reduction is related to the reduction of the wage in case of absence due to sickness in the first days approved for public employees (and extended to many the private sector), to the approval of new regulation to facilitate dismissal in case of (sick) absence and to the rising fear among workers to lose their job in a context of massive unemployment.

The compound effect of the destruction of employment and the fall in wages propitiated by the crisis and the labour reform has produce an intensification of the already existing process of deterioration of the labour share, from 53% before de crisis to 50% in 2013.

4. Conclusions

The process of fiscal consolidation and structural reforms carried over in Spain since May 2010 follows mimetically the economic policy imposed by the European Central Bank, the IMF and the European Commission in other EU intervened countries such as Portugal, Ireland or Greece, although in the Spanish case the "troika" intervention has been partial and limited to the financial sector. Both governments in power during the crisis have taken great pride in avoiding intervention, although in practice the policy applied has been very

[25] Raquel Díaz, *Las bajas laborales se desploman un 45,6% durante la crisis*, "Cinco Días", May 13, 2014.

similar and with identical results: deepening the intensity and duration of the crisis and its economic cost in terms of unemployment and forgone GDP.

In this respect is very important to highlight how to a large extent the decisions of economic policy were taken outside the boundaries of the country and by institutions such as the "financial markets" or the ECB that had no legal rights or competences to take them. In this respect, the managing of the Spanish crisis is a paradigmatic example of the conflict between globalization and democracy narrated, among others, by Dani Rodrik in his 2012 book *The Globalization Paradox*.

The epitome of such *de facto* translation of national sovereignty beyond national boundaries is the letter sent in August 2011 by the Governor of the Spanish Central Bank and the President of the ECB to the, at the time, President of the Spanish Government. In that secret (and until very recently unknown) letter, the senders (remember, with no competences whatsoever in labour issues) consider necessary to adopt the following measures:

> […] additional measures that will improve the working of the labour market:
> *a*) The decree of reform of collective agreements passed by the Spanish Government the 10th June should reinforce more the role of firm-level agreements in order to ensure the real decentralization of wage bargaining. Changes should be made in the parliamentary procedure in order to reduce the possibility that agreements at the level of the industry (at the regional of national level) could set limits on the applicability of agreements at firm level.
> *b*) Moreover, we are highly worried for the fact that the Government has not adopted any measure whatsoever to eliminate the clauses of indexation of wages to inflation.
> *c*) The Government should also take exceptional measures to promote wage moderation in the private sector.
> We also suggest the revision of other labour market regulations to speed up the reintegration of unemployed workers to the labour market. We see important advantages to the adoption of a new exceptional employment contract with very low dismissal costs […][26].

All these suggestions were promptly approved in subsequent reforms. Three years have passed since these events, and contrary to the expectations of all those proposing the combination of austerity and labour reforms as a quick way out of the crisis, the situation has worsened: more than one million jobs less and a reduction of GDP of nearly 3%. Considering the size of output and employment loss, it is of small comfort that expectations in terms of GDP growth are positive for the current year. Moreover, the compound effect of the recession and austerity measures has produced an increase in inequality and poverty[27]. In this respect, the most relevant facts are the rise of absolute poverty by roughly 65% from 2007 (just before the recession started) and the increase in income inequality by almost 8% during the same period (Muñoz de Bustillo, Antón, 2014). On the social expenditure side, the strong reduction in social investment in areas such as education and health is putting pressure on the delivery of major social services not only with important implications on the well-being of the population, but with major effects on future growth, putting at risk the future of a Welfare State that took so long to built. As argued by Taylor-Gooby (2011),

[26] The letter was reproduced in the book of memories written by President Rodríguez Zapatero (Rodríguez Zapatero, 2013, pp. 405-8).

[27] Both inequality and relative poverty had been decreasing since the middle 80s up to the early 2000s, when this process was interrupted. Since then, the Gini index remained roughly constant until de the Great Recession (Ayala, 2013).

pressures on the Welfare State may increase the feeling of insecurity, so that support for state provision grows, but does so in a climate of more equivocal trust in the capacity of the state to continue delivering good-quality services, something that might have the opposite effect on the level of support of the Welfare State. The decisions adopted in almost all fronts of social policy may alienate some groups of people from supporting the Welfare State as they grow weary of the future capacity of government to meet their needs, weakening one of the major elements of welfare state resilience: the strong support of a majority of the population.

References

AYALA L. (2013), *Crisis económica y distribución de la renta: una perspectiva comparada*, "Papeles de Economía Española", 135, pp. 2-19.

DE GRAUWE P. (2011), *Managing a Fragile Eurozone*, "CESifo Forum", 12, 2, pp. 40-5.

DE GRAUWE P., JI Y. (2013), *Self-fulfilling Crises in the Eurozone: An Empirical Test*, "Journal of International Money and Finance", 34, pp. 15-36.

IDD. (2014), *Disappearing Government Bond Spreads in the Eurozone-Back to Normal?*, CEPS Working Document No. 396.

DÍAZ SÁNCHEZ J. L., VAROUDAKIS A. (2013), *Growth and Competitiveness as Factors of Eurozone External Imbalances: Evidence and Policy Implications*, World Bank Policy Research Working Paper No. 6732.

ERNST & YOUNG (2011), *Turn Risk and Opportunities into Results. Exploring the Top 10 Risks and Opportunities for Global Organizations. Global Report*, Ernest & Young, London.

EUROPEAN COMMISSION (2008a), *A European Economic Recovery Plan*, Communication from the Commission to the European Council, COM (2008) 800 final, Brussels, November 26.

ID. (2008b), *From Financial Crisis to Recovery: A European Framework for Action*, Communication from the Commission to the European Council COM (2008) 706 final, Brussels, October 29.

KNIBBE M. (2013), *Looking at the Right Metrics in the Right Way: A Tale of Two Kinds of Models*, "Real-World Economics Review", 63, pp. 73-97.

MUÑOZ DE BUSTILLO R., ANTÓN J. I. (2013), *Those Were the Days, My Friend. The Public Sector and Economic Crisis in Spain*, in D. Vaughan-Whitehead (ed.), *Public Sector Shock: The Impact of Policy Retrenchment in Europe*, Edward Elgar, Cheltenham, pp. 511-42.

IDD. (2014), *Turning Back Before Arriving: The Dismantling of the Incipient Welfare State*, in D. Vaughan-Whitehead (ed.), *Dismantling the European Social Model: Europe Losing Its Soul*, Edward Elgar, Cheltenham.

MUÑOZ DE BUSTILLO R., DE PEDRAZA P., ANTÓN J. I., RIVAS L. A. (2011), *Working Life and Retirement Pensions in Spain: The Simulated Impact of a Parametric Reform*, "International Social Security Review", 64, 1, pp. 73-93.

OECD (2010), *Economic Outlook*, May, OECD, Paris.

RODRÍGUEZ ZAPATERO J. L. (2013), *El Dilema*, Editorial Planeta, Madrid.

RODRIK D. (2012), *The Globalization Paradox*, W. W. Norton & Company, London.

TAYLOR-GOOBY P. (2011), *Security, Equality and Opportunity: Attitudes and the Sustainability of Social Protection*, "Journal of European Social Policy", 21, 2, pp. 150-63.

UXÓ J., PAÚL J., SALINAS J. (2010), *Análisis y valoración de las medidas discrecionales de estímulo fiscal aplicadas en España en 2009*, "Presupuesto y Gasto Público", 59, pp. 55-82.