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No Light at the End of the Tunnel: Ideological and Systematic Causes of Spain's Economic Paralysis

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Abstract

Since 2008, Spain's economy has suffered from an unemployment crisis. In response, voters elevated the *Partido Popular* (PP) to power in 2011 after becoming frustrated with the *Partido Socialista Obrero Español*'s (PSOE) lack of effective action. However, since the election of 2011, very little has changed in Spain's stagnant economy. Unemployment remains high despite initially promising reforms in Spain's labor market and a bailout for Spain's larger banks in 2012 has done little to bring foreign investment back into the country. In this paper, I contend that the PP's timid response to the unemployment crisis is the result of a conservative ideology among political elites. These elites are empowered to maintain these policies by a weak legislative representation system, rampant conflicts of interest between the government and financial institutions, and pressure by the international community to continue austerity measures without a temporary increase in public spending.

Keywords

Spain, Spanish Government, Financial Crisis, Austerity Measures, Economic Policy

Introduction

Since 2009, Spain has been spiraling into an economic abyss. Unemployment has rocketed to 26 % (Burgen, 2014), Spanish banks have failed to meet modest recapitalization and leverage-ratio goals (IMF Staff, 2013) and negotiations between Madrid and Brussels/Berlin over future deficit spending remain deadlocked. Protests erupted last year in March after Madrid adopted more austerity measures, resulting in violent clashes with police around Madrid and in Catalonia. Notwithstanding these alarming economic and political trends, Spanish leaders are like deer caught in the headlights; frozen at a time when effectual economic reforms are desperately needed. Amidst the worst economic crisis Spain has faced since the Great Depression, Prime Minister Rajoy's wage reforms and negotiated bailouts have done little to change Spain's course. Although more drastic policy changes may be ahead for Spain, this paper contends that Spain's current policy outcomes have been determined by ideological forces that are protected by a weak system of checks of balances and international pressures based upon false premises.

Specifically, this paper will argue four points. First, I will show that conservative ideologies within the *Partido Popular* are the driving force for Spain's current economic policies. Second, I will show that Spain's party system shields top leaders from the immediate demands of Spain's population allowing the Spanish government to hold onto very unpopular positions. Third, I will briefly touch on how corruption may be reinforcing Spain's insistence that its banks remain in the hands of the private sector. Finally, I will argue that the EU's calls for austerity measures in Spain have allowed the *Partido Popular* to divert responsibility for its current crisis to the European Union, allowing the government to continue austerity measures despite wide spread protest among the Spanish population.

Party Ideology Provides A Stumbling Block

When the *Partido Popular* (PP) came to power in 2011, Prime Minister Rajoy was vague about what reforms he would choose to follow through with. Prior to the election, Mariano Rajoy's party said little about the substance of its economic policies, instead relying on the ill-will felt towards the *Partido Socialista Obrero Español* (PSOE) to propel the PP into office (The Economist, 2011). However, once in office President Rajoy closely followed the PP's ideological values in his approach towards the recession and high unemployment in Spain. This section will outline the main values that the PP has historically stood for, and link these values to the current policy outcomes observed in Spain.

The *Partido Popular* is a mainstream conservative party similar to the United States' Republican party on both social and economic issues. On social issues the PP advocates for strong families, anti-materialist morals, a strong national state that can preserve unity (Wikipedia, 2014), and denied giving same sex couples marriage rights in 1996 (Gibbons, 1999). On the economy, the PP advocates for market friendly liberalism, greater flexibility in the job market, cuts in public expenditures, a decrease in high level office holders, private initiative in entrepreneurship, and a restructuring of the social service delivery system (Gibbons, 1999). In addition, the PP is vehemently opposed to government economic involvement, particularly nationalization and high rates of taxation linked to extensive governmental services.

When the PP came to power in 2011, it followed the playbook it had been preaching for decades. In 2012, President Rajoy initiated ambitious labor market reforms intended to create greater flexibility in Spain's job market (Pettis, 2013). After the PP pushed through a particularly aggressive labor reform, President Rajoy said he expected to see protests in the streets. However, few Spanish citizens claim that reform is unnecessary; Spain's current job market gives iron-clad work contracts to two-thirds of the work force while the other third of temporary workers are let go by companies skittish to hire anyone in such economic uncertainty (The Economist, 2012b). Initially, it seemed that the PP would be the party of action that Spain needed to revive itself. The OECD hailed President Rajoy's reforms as good progress, but qualified the compliment by saying that more active measures aimed at lowering unemployment would be necessary (Pettis, 2013). So far, the Spanish government's efforts in that arena have been insignificant. According to the PP's platform, inaction is the correct response. Theoretically, minimal governmental intervention combined with flexible job markets should allow the private sector to work out the unemployment problem on its own. Despite anemic growth, the PP has stuck to its guns; there have been no major increases in public spending since President Rajoy took office.

The Spanish government's response to its banking crisis has been similarly influenced by the PP's ideology. The PP has historically been opposed to government intervention in the economy, and reaffirmed that position again in 2012. Unlike Greece, which begged for a bailout from the ECB in 2010 (Weisenthal, 2010), Spain claimed that its banks were more well protected from the housing crisis fall-out of 2009, and refused to accept a bailout from the ECB in 2012 until President Rajoy received a promise that the money would be a loan with no strings attached. Spain's economic minister even went so far as to claim that the 100 billion euro loan requested by Spanish banks, was "in no way … a rescue" (The Economist, 2012a). Though the PP may have been forced to bend on their ideals, their rhetoric on the financial sector regulation remains staunchly pro-market, with little government interference.

Weak Institutions Create Compliance

Understanding the ideology of the PP is essential in explaining the Spanish government's current policies, but the institutions that created these policies have also played a critical role in preserving the *Partido Popular's* unpopular positions. The Spanish executive branch is exceptionally strong and well protected relative to the Spanish legislature, allowing party leaders to create economic policies that are relatively unchallenged by the opposition or dissenters within their own party. Despite the reforms intended to change this system included in Spain's current Constitution, the legislature has yet to gain an equal footing with the executive branch after decades of insignificance.

In the 1960's and 70's, the Spanish legislature's check against the executive was overridden by the Franco regime, and it became a de facto rubber stamp organization. Although the Spanish legislature (The Cortes) was given more power in the Post-Franco 1978 constitution, the overarching behavior within the Cortes did not radically change; previous legislative reforms have only intensified negotiations among competing parties about what positions they will hold within the government. In his book, Spanish Politics Today, John Gibbons (1999) suggests that the current structure of the Spanish Parliament gives the elite members of the Cortes enormous financial power, especially when one party has an absolute majority within parliament. Within the upper house (the Senate), and the lower house (the Congress of Deputies), members of parliament are divided into "parliamentary groups" that have a minimum of 15 members in Congress and 10 members in the Senate. Deputies unable to form a coalition large enough to create a parliamentary group must become members of the "Mixed Parliamentary Group", which requires groups with potentially very different points of view to speak with one voice. Membership within a parliamentary group is linked to the reception of state subsidies, effectively mandating that deputies remain loyal to a parliamentary group once elected. Once a parliamentary group is formed, they are given a voice on the "Board of Spokespersons" that coordinates with the internally elected Presiding Councils to determine who will be appointed to what committees and how the agenda in the current legislative session will be set (p. 69). This structure effectively drowns out minority voices within the mixed parliamentary groups and squashes dissent within the ranks of larger parliamentary groups because deputies can be severely punished by party elites. In consequence, debate on controversial issues rarely becomes substantive in the Cortes because parliamentary influence and re-election campaign funds are tightly tied to party loyalty. In addition, because the ruling party has direct influence over who may become the prime minister, there is little need for the Spanish Parliament to produce legislation independent of the actions of the executive branch (p. 76).

The cumulative effect of this system is that the Spanish party elites have enough leverage to ignore the demands of newly elected officials representing troubled districts, contributing to the deafness of the *Partido Popular* in the wake of challenges that the unemployed face (Gibbons, 1999). However, even if the Cortes were a more robust organization, the office of Prime Minister is so well protected that regime change would be highly unlikely. President Rajoy can only be thrust out of office if an absolute majority in both houses of the Cortes rejects him, *and* there is an alternative candidate that can be agreed upon. These structural protections give the top echelons of Spanish officials enormous influence over their subordinates, and have set the stage for acts of corruption in that may be tying the hands of the PP in the midst of endemic unemployment (Gibbons, 1999).

Corruption Suppresses Financial Reforms

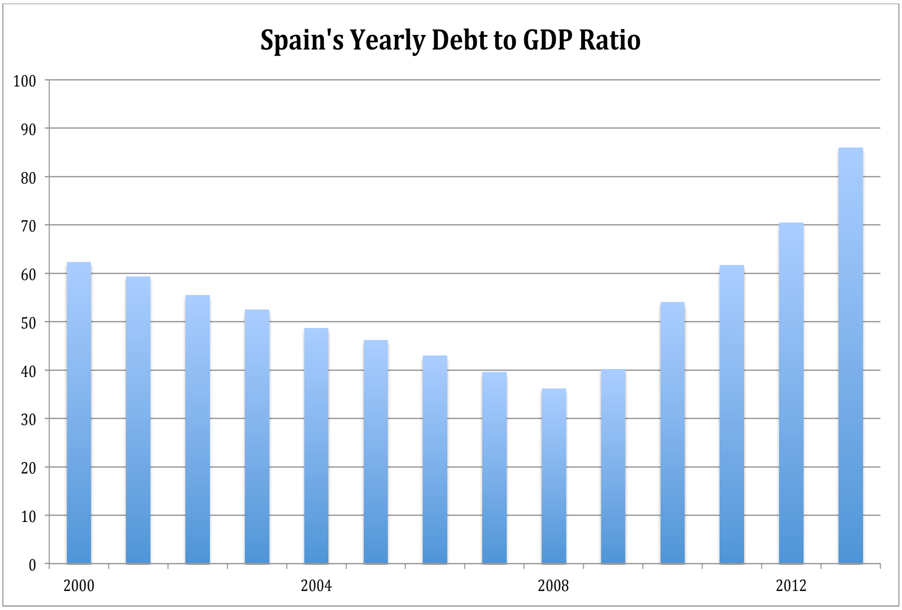
In light of the immense protections Spanish politicians are given by Spanish laws, it is probable that corruption has reinforced the PP's ideology. Party elites simply cannot afford large banking institutions to go belly up because bankrupt banks have their books thoroughly examined and made public. If this were to occur in some of Spain's larger banks, many speculate that the books would reveal spectacular corruption within the highest levels of government. Corruption is a long standing problem in Spain, during the 1990's Spain suffered from an astonishing run of corruption cases, touching so many of the political elite that many Spaniards felt that the entire system had become corrupt (Gibbons, 1999). Although the *Partido Popular* rode to power in 1996 on the promise of major corruption reforms, these reforms never materialized, and as a result members of the Spanish Cortes enjoy immunity from almost all types of prosecution while in public office (Newton & Donaghy, 1997) . While it is impossible to know what lies within the books of Spain's largest banks, it has been shown that legislative immunity has allowed for an unusually cozy relationship to develop between smaller, community banks and the government. In 2012, *The Guardian* reported that Spain's financial crisis had revealed a number of community banks that had been stuffed with board members that knew little to nothing about finance. These corrupt financial boards gave approval to all actions requested by banking executives, including massive executive pay raises, "soft loans" to family and friends of board members, and expensive vacations disguised as meetings (Tremlett, 2012). After the political fallout of those investigations, it should not be surprising that Spain's largest political parties have blocked an investigation into Bankia, one of Spain's largest banks, after Bankia requested a 19 *billion euro* bailout loan (Tremlett, 2012) . While this was an unpopular move, as long as party elites maintain control over the executive and legislative agenda of the government, evidence about current corruption will only come from autopsies performed on banks allowed to fail. Thus, it is probable that the leaders of the PP have a major conflict of interest in preserving the health of Spain's largest banks, leading to massive public debt transfers without adequate public oversight.

International Pressures Reinforces the PP's Economic Policies

While It is true that the PP's austerity policies have been largely self-imposed by conservative leadership, it is also true that these measures have held much support from the international community. However, the reasoning of those interested in recommending austerity measures to Spain is fundamentally flawed, and has only been complimentary to President Rajoy's own agenda while simultaneously providing the Spanish government a scapegoat for the negative consequences that Spaniards have suffered at the hands of their own government.

Beginning in 2000, Spain believed that it had achieved a sustainable growth rate of approximately 1 %. Compared with other Mediterranean EU members, Spain's finances looked to be highly stable, with Spanish banks claiming to be more conservative than their Mediterranean counterparts until the collapse in 2008 (Trading Economics, 2013). However, after the crisis of 2008, Spain discovered that its 1 % growth had been the product of excessive liquidity that had allowed banks to accrue excessive debt within the housing sector (Munchau, 2012) . These debt problems were compounded by the market's response to revelations implying that not all EU nations were equally sound investments. As the extent of the financial damage caused by the 2009 crisis became clear, Spain was cut-off from cheap credit as financial markets hedged against the risk of default. This panic became a self-fulfilling prophecy; without access to the credit markets, Spain was unable to balance the debt on the banking sector's books without foreign aid (Grauwe & Ji, 2012) . Thus, Spain's fate rested heavily on the European Central Bank's willingness to recapitalize its banking system.

This gave Germany and the European Central Bank a tough decision. Spain's banks were facing multi-billion dollar shortfalls that could threaten the entire EU banking system (Tremlett, 2012), but providing a bailout would be politically unpopular in both Germany and Spain. In Germany, a Spanish banking sector bailout appeared to reward *the nation* of Spain for excessive spending habits. In Spain, a bailout appeared to reward *the banking sector* after years of corrupt and destructive banking practices. This perception problem gave German politicians room to claim that Spain's difficulties were a result of gluttony and fiscal recklessness, and pointedly claimed that if Spain were simply more like Germany, Spain would not be faced with so many fiscal challenges (Pettis, 2013). This narrative resonated well with the German population, but the facts are not aligned at all with this narrative. Prior to 2008, Spain possessed one of the smallest debt-GDP ratios of the entire EU (Blyth, 2013). If Spain's current unemployment problems were the result of excessive public expenditures, then Spain's debt ratio before the crisis of '09 should show high spending in the public sector. However, between 2000 and 2008, Spain's debt to GDP ratio lowered to below 40 %, one the lowest levels within the European Monetary Union.



Source: Trading Economics (2013a)

The difference between where Germans and Spaniards place the blame for Spain's financial crisis become pivotal in 2010, when European nations were framing the debate about whether to recommend general austerity measures or focus on stricter financial regulations. When Germans successfully placed the blame for Spain's financial crisis on the nation as a whole, recommending austerity measures became reasonable. However, for most of Spain's newly unemployed workers, large-scale austerity measures have been perceived as immensely unjust, as managers of Spain's financial institutions remain untouched by the suffering of most Spaniards.

As shown in the above graph, German claims that excessive public debt ratios in Spain were the precursor to the financial fall-out of 2009 doesn't hold up under investigation; it was not government debt that landed Spain in the worst financial straits it has experienced since the great depression. Nevertheless, Germany's nationalistic rhetoric created an expectation that Spain should begin issuing austerity measures before Spain's 2012 bank bailout was even asked for. Like the *Partido Popular*, Germans have been recommending large cuts in public programs that would theoretically benefit Spain by increasing private sector spending. However, this position has not been made without opposition, some Spanish politicians claimed that cuts in public spending have deprived Spain of the two tools needed to pull the country out of recession: public sector employment and inflation (Evans-Pritchard, 2013).

These discussions have led some observers to wonder if Spain might leave the European Monetary Union entirely. Several studies have indicated that a devaluing of the Spanish currency and an increase in the money supply could significantly reduce unemployment by compensating for Spain's rising loan costs (Rosnick & Weisbrot, 2013) . However, should Spain leave the Euro, control of inflation would be placed back in the hands of the President of Spain, who could decide to print the currency into an even worse condition while supporting popular domestic spending programs. In addition, in a personal interview with the author in 2013, Eckhard Wurzel, a Chief Economist at the OECD, argued that any currency backed by Spain would rapidly fall in value relative to the Euro because Spain would be unable to acquire the Euros necessary for repayment without resorting to hyperinflation. Because the conversion rate between the Euro and the new Spanish currency would be difficult for the Spanish government to control, issuing a new currency would deny Spain the ability to pay back the loans it has already received in Euros, effectively guaranteeing default (Wurzel, 2013). Finally, if Spain shifted currencies, it would be faced with an even higher interest rate in the bond market as rates compensated for Spain's lack of EMU backing, leaving Spain without *any* sources of financing. Though the European Central Bank and Spain's government balked before creating the debt-relief program necessary for Spain to cleanse itself of its toxic assets (Munchau, 2012), without the ECB's support Spain's banking sector could collapse, an unacceptable outcome that would destroy much of the EU's banking system.

What is fascinating about these pressures is that the demands of the EU upon the Spanish government align with the ideological position of Spain's current ruling party, which makes the "resistance" against the EU's austerity measures an elaborate double game intended to shift some of the blame for Spain's austerity policies from President Rajoy to Chancellor Merkel and the EU central bank (The Economist, 2012a). In a shrewd application of diversionary theory, the *Partido Popular* has managed to shift the narrative of austerity away from Socialists vs. Conservatives, and instead create an "Us vs. Them" argument that has bought the *Partido Popular* more maneuvering room. Prime Minister Rajoy is treading a thin line though; if his tactic backfires, the *Partido Popular* could lose power to a more extreme political party willing to pull Spain out of the European Monetary Union to put more Spaniards back to work in the short run.

Conclusion

Spain's economy has devolved from a stable growth area into a nation trapped with high unemployment and little to no economic growth. Although Spain is a functional democracy, the structure of the executive and legislative branches has enabled the *Partido Popular* party elites to continue pursuing austerity measures in spite of little improvement in Spain's economy. This will continue until a significant change takes place. If an economically liberal regime takes power, it is possible that Madrid could seek to stimulate the economy through the expansion of government programs in order to appease the population. However, if more radical anti-establishment parties continue to gain power, a new EU skeptic coalition could choose to reassert the authority of the government's authority over its monetary policy by leaving the EMU altogether. The recent May 25th European Parliament elections indicate that Spain's mainstream parties, the PP and the PSOE, have both lost significant ground to smaller Euro skeptic parties like the *Podemos* and *The United Left* (Wikipedia, 2014a). Regardless of whether Euro skeptic parties are able to create a majority in parliament, if the general elections follow this same pattern Spain's new governing coalition will be placed under much more pressure to distance itself from the EU and initiate policy changes that would contradict Brussels' and the PP's current austerity policies.

Another possible avenue of change could be further reforms allowing representatives in the Cortes to become more involved in the policy making process. A strong legislative branch would make the pain of high unemployment felt more keenly by party leaders in the executive, thus prompting more timely action aimed at relieving the burden of unemployment. There are several ways this could be accomplished: one way would be to allow the Cortes oversight over the selection of a Prime Minister's cabinet members, and a mechanism of applying pressure on individual cabinet members. Another possibility could be the dissolution of the forced grouping system that isolates incoming congressional deputies from other coalitions and diminishes the power of smaller parties by grouping them into "mixed parties". Either way, as long as the executive government continues to enjoy the enough power to carry out ideologically driven policies, those policies may not be in the best interests of Spain's working population.

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