A Perfect Storm in a Sunny Economy:

A Political Economy Approach to the Crisis in Spain

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Abstract

Although Spain's economy was seen as a miracle during the most recent expansive phase (for its labour market outcomes in terms of job growth, among other things), the economy's development during those years suffered from severe problems that deserve attention. This became more relevant in a context like the current one, where there is no consensus around which economic policies might lead the country back onto a stable growth path. Using a systemic approach in which we analyse the growth model, the role of Spain in the European division of labour, the financial sector, the labour market, the public sector, and the distribution of income, we contend that, in contrast with several narratives concerning the crisis in Spain: i) the 'living-beyond-our-means' discourse is not true; and ii) certain political economic aspects, usually missing in those narratives, are essential to understanding the recent evolution of Spain.

Keywords: Political economy; systemic approach; growth model; distributive struggle; 2008 crisis; Spanish miracle.

JEL classification: P16 Political Economy; O15 Income distribution; O52 Europe.

1. Introduction

Since 2009, Spain has suffered its worst economic crisis in decades. When the two main governing parties, the conservative Partido Popular (PP) and the social democratic Partido Socialista Obrero Español (PSOE), began to implement austerity policies to take the country out of the crisis, politicians of both parties commonly gave as justification the notion that Spaniards had been living beyond their means for many years. José Blanco, then Minister for Internal Development of the PSOE administration, said in September 2011 that '[…] we have lived beyond our means. […] we all have probably loosened our belts too much for some time […].' (our translation from Recuero and Delgado, 2011: pp. 10-11). In January 2012, the regional President of the autonomous community of Valencia similarly stated that the region had lived beyond its means, adding that 'We were all at the top of the wave enjoying the moment.' (our translation from El Mundo, 2012). Some months later, Primer Minister Mariano Rajoy declared that 'We cannot spend what we do not have […] living permanently beyond our means is not good' (our translation from Cinco Días, 2012).

With this common diagnosis in mind, it is no surprise that austerity policies were chosen to remedy the crisis. Indeed, in accordance with the aforementioned politicians, several international organizations proposed austerity plans for economies like Spain (IMF, 2010; European Commission, 2011; see also Sinn, 2014). In recommendations by the IMF for its Article IV Mission, the Fund was still insisting in 2016 on the need to introduce new cutbacks to healthcare and education (IMF, 2016).

This perspective, shared by both national politicians and international organizations, had an impact on the population, inasmuch as it spread feelings of guilt (Alonso *et al.*, 2013; Sabaté, 2016). However, there is a stark contrast between this assessment of what had happened during the expansive phase, and the euphoria that many politicians shared with certain European institutions prior to the crisis.

Many economists labelled the expansive phase in Spain as a new 'economic miracle' (Becker, 2004; Bernaldo de Quirós and Martínez, 2005; see also Royo, 2009; Charnock *et al.*, 2014: pp. 67-69). Politicians in turn ignored any signs of coming danger that would spoil their narrative of economic success. Such was the case with Rodrigo Rato, Finance Minister under the PP government who declared in 2003: 'We are not facing a bubble but very strong demand that continues, but that is beginning to show more moderate behavior' (our translation from Cinco Días, 2003). Likewise, the social democratic government denied in 2007 that any bubble was bursting, stating that construction firms were sound, and with a hopeful future (Europa Press, 2007), and boasting that the economy 'had joined the Champions League' (quoted in Chislett, 2016: p. 22). This optimism, common among economists with links to the parties in government, also reached the European Commission, which considered Spain a model for new European Union (EU) members to follow (Missé, 2007). Even rating agencies gave top credit assessments to the Spanish state and most banks in the country (Otero-Iglesias *et al.*, 2016: p. 50).

Today, it is clear that the crisis has been the deepest since the Spanish Civil War (1936-1939) and the devastating consequences thereafter. As shown in Figure 1, and compared with previous episodes of financial distress since the beginning of the democratic period in 1975, no other recession had a greater impact in terms of GDP and GDP per capita. How could such an 'economic miracle' vanish so quickly?

Figure 1 *Impact of economic crises in Spain*

Despite this evidence, as late as of 2010, the current (PP) Minister of Finance coordinated a book in which once again sustained the idea of the erstwhile expansive phase as worthy of admiration and emulation – not the whole phase, but just the period in which the PP had governed the country (Guindos, 2010).

Since that time, several academics have provided alternative analyses of the crisis, moving past such adherent praise. In effect, they note that the years of economic growth were also characterised by increasing external, productive, and/or monetary imbalances (for example, Royo, 2009; or De la Dehesa, 2012). These analyses have offered different, more nuanced views of the growth period. Yet they sometimes continue to promulgate the idea that the excesses leading to imbalances were general – thus contributing to the aforementioned feelings of guilt (for example, in Royo, 2014a: p. 1575).

Here our goal is to contribute to the literature on the crisis in Spain by combining a heterodox economics approach with a political economy approach. In doing so, we follow the lead of other analyses (for example, Garcia-Arias *et al.*, 2013; Charnock *et al.*, 2014) in an effort to complement them. We focus on the following two arguments, which serve as the base for our thesis: i) the 'living-beyond-our-means' hypothesis is by no means a forgone conclusion, based on empirical evidence of what occurred during the expansive phase; and ii) certain political economic aspects are essential to understanding the overall picture of Spain’s 'miraculous' expansive phase.

In order to defend our thesis, we analyse the economy during the years prior to the crisis: the period of 1996-2007, the latest expansive cycle of the Spanish economy. In addition to contributing to ongoing debates, our analysis is made further relevant by two considerations: on the one hand, Spain is the largest EU economy where the crisis hit hardest, making its study in the current context of utmost importance (European Commission, 2013: p. 19); and this paper can be seen as complementary to studies on the emergence of new actors in the European periphery in general, and of Spain in particular (see, for example, Huke *et al.*, 2015), shedding light on the political economic factors that came together during the growth period to produce such political outcomes.

We will employ a systemic approach to the economics of Spain, considering all the components of a modern economy and including the political aspects that help in understanding the functioning of the whole. This approach shapes the structure of the paper, which is as follows. In Section 2, we analyse the pattern of growth followed by Spain, from both the supply and demand sides. Section 3 examines the role of Spain in the European division of labour in order to grasp certain contradictions in the model. Section 4 is devoted to the financial sector, preceding our analysis of the labour market in Section 5. The sixth section helps to complete our explanation by explaining the role played by the public sector. Section 7 addresses the distribution of income, and finally, Section 8 focuses on the political economic aspects accompanying the previous, allowing deeper understanding of how the model worked. Finally, Section 9 offers some concluding remarks.

2. The growth model

The supply side of an economy reveals the factors upon which its growth has relied, the efficiency with which those factors have been used, and the economic sectors that have been predominant. Table 1 shows first that economic growth reached very high rates, with a yearly average for the overall 1996-2007 period of 3.7 percent (the corresponding figure for the euro area was 2.3 percent). Second, we observe that this growth was based on an accumulation of factors rather than an increase in their productivity.

Table 1 *Supply side growth (1996-2007), yearly average*

Labour productivity (Y/L) grew at very slow rates. Considering labour productivity as a relationship between K/L (which illustrates how productive factors were combined) and K/Y (the degree of capitalization of production), we find that capital grew faster than employment, thus capitalizing the economy. Capital accumulation reached a rate of 4.1 percent yearly, mainly due to a greater increase in residential capital than in productive capital. This reveals the type of specialization followed by Spain during those years.

As evidenced by figures on expenditures in research and development (R&D) and on patents per inhabitant, the levels of technological capital were below the EU average when the crisis began. In 2007, Spain invested 1.2 percent of its GDP in R&D, while the average for the euro area was 1.8 percent; concerning outcomes, in the same year, applications to the European Patent Office made by Spanish researchers per one million inhabitants were at 30.95, the euro area figure being 146.88 (all data from Eurostat, Science, Technology and Innovation).

Focusing now on the sectors to which production was allocated, data from the INE (Spanish Statistical Office) illustrate the increase in the share of the construction sector vis-à-vis the whole economy, such that from 1995 to 2007, that sector's share of GDP in real terms rose from 8.8 percent to 12.3, offering the most salient view of how the structure of the economy was evolving. Likewise, using data from the European Commission's annual macroeconomic database (AMECO), the share of construction in total value added in 2007 was much higher in Spain (at 11.2 percent) than the equivalent in France (6.1), Germany (3.9), Italy (6.0), or the United Kingdom (6.9), those being the EU countries with more inhabitants than Spain.

We can attribute the extraordinary growth experienced by the building sector to: i) the inflow of new populations attracted by a labour-intensive growth pattern (thereby increasing demand for new homes); ii) the arrival of European tourists who chose to purchase apartments on Spain's coasts; iii) the improvement of financing conditions, as a consequence of Spain having entered the EU (we will return to this later); and iv) the existence of a speculative bubble, which drained money from other sectors to provide extraordinary profits. In contrast, the sector of industry and energy decreased in the same period, from 20.3 to 15.6. Inside industry, high-tech manufacturing, whose weight at the beginning of the period was already lower than the EU average, declined throughout the remaining years (data from INE, National Accounts). Thus, we see how the construction sector became once more the national specialization of the country, to the detriment of the other sectors.[1]

This pattern of specialization, in turn, helps to explain the evolution of productivity, which was greater in industry and agriculture – sectors whose importance diminished during the period under study. Indeed, Mateo and Montanyà (2014) show with data from AMECO that, of the twelve years between 1996 and 2007 (inclusive), only in three did construction contribute positively to the increase in productivity. Considering the economic weight of that sector, it is not surprising how overall productivity evolved.

Regarding demand: domestic demand was key to understanding the growth model adopted by Spain. Both consumption and investment played important roles in the macroeconomic development of the economy, but the performance of investment was especially outstanding. According to data from the INE, Gross Fixed Capital Formation (GFCF) reached yearly growth rates amounting to 6.1 percent for the whole period, and 7.2 percent between 1996 and 2000. This was closely related to the rate at which the economy accumulated capital, as previously stated. Consequently, this segment of domestic demand represented 21.4 percent of GDP in 1996, and 30.7 percent in 2007.

As seen in the specialization of the economy, the share of residential investment was large, and it grew throughout the period as follows: in 1996, up to 32.6 percent of investments were dedicated to this physical asset, while in 2007, that figure was almost 40 percent. Meanwhile, investment in machinery accounted for 21.3 percent in 1996 but only 16 percent in 2007 (all data from FBBVA, 2014). The analysis performed by Mateo and Montanyà (2014) shows that real estate prices increased much more than prices in the rest of the economy, thus driving increases in the macroeconomic variables of the sectors involved (namely, construction and housing services). In addition, those sectors showed only slow increase in their respective productivities, which drove overall productivity figures down. Finally, the sectors drained a vast amount of resources from the rest of the economy, which contributed to shaping the growth pattern.

3. Spain and the European division of labour

Apart from Spain's domestic specialization, it is important to examine the country's role in the European division of labour. Analysis of the balance of payments of Spain shows that as consumption grew, the current account balance increased its deficit due to the increase in imports. Those deficits in the balance of goods had been traditionally financed by a surplus in the balance of services, mainly due to the income generated by tourism; however, following the end of the 1990s, this evolution changed, and the surplus in services was insufficient to compensate for the deficit in the balance of goods. The economy, which was a net lender in 1997, 'had a current and capital account deficit of 9% of GDP in 2007, one of the highest among the developed countries' (Banco de España, 2017: p. 32).

The following two main factors account for this evolution: on the one hand, the fast growth of domestic demand in a context of cheap credit; on the other, a worsened position in the European division of labour. Concerning the evolution of domestic demand, both the types of goods imported and the overall economy's dependence on energy had negative impacts. More than half the demand of productive investment had to be covered by imports (Febrero and Bermejo, 2013: p. 268), which posed a clear vulnerability.

Concerning the second factor, Spain has traditionally featured a lower share of exports in its GDP compared to its European neighbours. In addition, the Spanish economy is specialized in goods with lower technological content (i.e., products that are less competitive in international terms). Indeed, in the case of intra-industry trade (which amounts to as much as 70 percent of all trade, according to data from Eurostat), it is interesting to note how Spain's economy imports goods belonging to the same industry that it exports, the former being less advanced than the latter, thus negatively contributing to the current account balance of the economy. Consequently, the coverage rate (exports over imports multiplied by 100) declined throughout the whole period, from 85 percent in 1998 to 65 percent in 2007 (Eurostat, International Trade).

Furthermore, data from Álvarez and Luengo (2011) show that Southern European countries (including Spain) and 'Enlargement' countries manifested structural trade deficits in the years under study, while core EU countries experienced trade surpluses. The latter enjoy greater trade advantages, with quantitatively more important specialization in high-tech products and capital goods. We can see a paradigmatic symmetry between Spain and Germany across several macroeconomic variables, such as their current account balances, or the role played by internal demand (Garcia-Arias *et al.*, 2013: p. 833; Charnock *et al.*, 2014: pp. 128, n.2).

All these imbalances led several sectors to propose austerity measures to remedy the crisis in Spain, as mentioned in Section 1. However, as Felipe and Kumar (2011) observe, the increase in Unit Labour Costs (ULC) in Spain came due to an increase in the price deflator used to calculate labour productivity. This led the authors to propose the following two alternative explanations to the trend followed by Spain: i) firms in the least exposed sectors (those most protected from international competition) increased their mark-ups and augmented their share in the whole economy; and ii) those same firms increased their mark-ups in greater proportion than the decrease made by firms in sectors effectively exposed to foreign competition. This argument serves as a useful starting point to think about winners and losers in this pattern of specialization, a subject to which we will return later.[2]

If, as we have noted, trade could not be used to finance Spain's external imbalances, a new source had to be found elsewhere. Until Spain entered the Economic and Monetary Union (EMU), devaluation of the national currency (the peseta) was a viable way to balance the economy. However, this is no longer an option. Spain's membership in the EMU helped the country to attract foreign capital, obtained mainly by credit institutions through sales of securities backed by their loan portfolios (Banco de España, 2017: p. 32). In this process, Spain became the country with the second-highest levels of securitization in Europe (after the UK; Otero-Iglesias *et al.*, 2016: p. 24).

In this way, the economy filled its gap between private investment and savings, in a context where the public sector had achieved both surplus and debt reduction: Spain became an outstanding member of the EMU in fulfilment of the Maastricht criteria, in such a way that, while government deficit amounted to -5.4 percent in 1996, it turned to surplus after 2004, reaching 2.0 percent in 2007. Furthermore, general government debt decreased from 65.6 percent of GDP in 1996 to 35.5 in 2007 (all data from Eurostat). Undoubtedly, the external imbalance was a major vulnerability of the expansion process, and it had its origins in the private sector: household and non-financial corporation debt amounted to 83 percent of GDP in 1997, but by 2007 it had risen to 218 percent of GDP (the figure for households alone was 84 percent), half of which was debt related to construction (Febrero and Bermejo, 2013: p. 269).

In sum, the high rates of investment discussed in the previous section were financed with funds from abroad, in a context of low interest rates; this increased the country's vulnerability as debt grew larger, and especially because internal growth was based on such fragile fundamentals as the increase in housing prices (i.e., a bubble, which would burst sooner or later).

4. Financial sector

The financial sector of Spain has traditionally been formed by three types of institutions: banks, savings banks, and credit unions. The first two historically accounted for over 95 percent of deposits in Spain. The difference between these is that banks are conventional private-sector financial corporations, while savings banks took the form of quasi-public institutions with certain social aims among their intermediation activities. However, laws passed in 1977 and 1982 allowed for some changes to their mode of functioning. From 1977, savings banks could emulate banks in most activities (in a trend seen elsewhere as well; see Klimecki and Willmott, 2009), and since 1982, the weight of political parties in the decision-making processes of savings banks was reinforced.

Until the 1980s, savings banks were more specialized around the household sector, while banks specialized in the corporate sector; but these differences eroded. While pursuing their traditional business model, savings banks found sufficient capital for their operations through profit capitalisation, but as they came to resemble commercial banks, they also had to resort to wholesale financing (Banco de España, 2017: pp. 47-

48). Therefore, savings banks and commercial banks found themselves having to borrow over a quarter of their balance sheets on the interbank lending market, chiefly from Germany and the Netherlands (Fernandez-Villaverde and Ohanian, 2010: p. 10).

This was a direct consequence of both increasing economic activity and the opportunity that EMU membership had opened. Faced with a relative decrease in their net interest income, financial institutions chose an extensive strategy to increase credit provision at an annual rate close to 30 percent at the end of the expansive phase, allowing them to experience an increase of net interest income in absolute terms (Banco de España, 2017: p. 35). Savings banks were for the most part responsible for this credit expansion (Ruiz *et al.*, 2016: p. 1561).

Credit allocated to the construction and real estate sectors grew by 15.7 percent yearly, on average, between 1995 and 2007 (Molero-Simarro, 2014). Commercial banks were in this case the main providers of that credit, instead of savings banks, despite the general increases made in credit by the latter (Ruiz *et al.*, 2016: p. 1561). In contrast, credit to high productivity sectors, or even to SMEs, was scarce (Fishman, 2012: p. 71), in a country where 94 percent of companies have fewer than 10 employees (Chislett, 2016: p. 109).

The degree of financial concentration has been traditionally high: five institutions (three banks and two savings banks) owned on average half the assets of the whole financial sector. This high concentration allowed a small number of commercial and savings banks to dominate corporate finance and to enjoy high interest and profit margins, despite very high cost margins (Pérez, 1999). Profitability improved as a consequence of the securitization process mentioned above, and profits grew 'at a faster pace than […] capital or assets', reaching a return on equity of 20 percent in 2007 (Banco de España, 2017: p. 43).

This high degree of concentration was compatible with a high level of deregulation: during those years, Spain received the highest score in the deregulation index devised by Abiad *et al.* (2008), reaching U.S. levels (Figure 2). The aversion to financial regulation over the period was implicitly acknowledged in a recent report by the Banco de España (2017: p. 61), which stated that although we now believe that certain measures could have been taken for banks to limit risks (that would end in financial crisis), 'the international regulations of the time did not provide for the use of such macroprudential tools'. In effect, the adherence of Spanish and European regulators to the trend of 'banks' self-regulation' led to a situation of 'regulatory forbearance' (Otero-Iglesias *et al.*, 2016: pp. 49-50; Ruiz *et al.*, 2016: p. 1569).

Figure 2 *Deregulation index in the financial sector, 1973-2005*

The financial sector was therefore completely functional to further development of the pattern of specialization, and deregulation contributed by making financial institutions less reluctant to lend.

5. Labour market

The labour-intensive growth model already described needed a specific labour market. Moreover, the 'guilt' narrative mentioned above had an equivalent in the labour market, whose purported 'rigidity' became the object of frequent criticism (see several examples in Fernández Rodríguez and Martínez Lucio, 2012: p. 314). However, as had been the case in the financial sector, labour market deregulation was notably increased from the 1980s. Until the mid-1990s, labour market reforms aimed at making entry more flexible (through the use of fixed-term contracts); after that time, the goal became to make exit more flexible (lowering dismissal costs) (Sola *et al.*, 2013: p. 70). The other major trend in labour market reforms has been the decentralization of collective bargaining, which was considered a main source of inflationary pressures (Nonell *et al.*, 2006: p. 362).

The 'economic miracle' discourse finds in the labour market the incarnation of the model's virtues. In effect, Spain reached its lowest unemployment rates since democracy during the expansive phase. Furthermore, it created one out of three jobs in the EU during those years. However, a detailed analysis shows that most of these were low-skilled jobs, closely linked to the construction and real estate sectors and with high sensitivity to economic cycles. Indeed, the consensus between the PP and the PSOE concerning labour market reforms has made Spain the European country with the highest rates of temporary contracts, thereby increasing precariousness in the labour market (Recio and Banyuls, 2004; Fernández Rodríguez and Martínez Lucio, 2012: p. 322).

Further, Spain was the only OECD country whose average salary decreased in the period of 1995 to 2005. Low wages in the context of an abundant labour force allowed firms to avoid implementing measures to increase productivity and competitiveness, enhancing a low-salary low-productivity model (Sola *et al.*, 2013: p. 72).

Despite the discourse of a rigid labour market, it is worth highlighting that employment protections decreased in Spain from at least 1990, to reach the average in continental Europe by 2008; according to the World Bank, Spain became a country where dismissal regulation was less strict than in most Europe (Sola *et al.*, 2013: pp. 77-78). In that context, it comes as no surprise that legislation has not been an obstacle to job loss since the outbreak of the crisis (Fernández Rodríguez and Martínez Lucio, 2012: p. 318). Meanwhile, researchers have challenged also the idea that the collective bargaining system does not lead to greater inflationary pressures (Nonell *et al.*, 2006: p. 364).

Therefore, the reforms applied to decentralize collective bargaining and to reduce firing costs should be understood in their political economy context. Both were useful to provide the kind of labour force required by the growth model, and both contributed to harming union power (a trend that began prior to the expansive phase, as shown by Toharia and Malo, 2000: p. 311, concerning the 1994 reform).

6. Public sector

The public sector also played a crucial role in the shaping of the overall model. Spain's public sector has traditionally been underdeveloped compared to the EMU average: although it has grown during the democratic period, it has never reached the average of euro area economies. In the case of expenditures, Spain did approach that average (only two percentage points lower in 2012, in the middle of the crisis), but in terms of revenues, the gap was never smaller than four percentage points (OECD, 2016). Despite a relatively small public sector, Spain underwent an adjustment process during the expansive phase: on the one hand, both parties in government (PP and PSOE) shared the idea that the weight of the public sector should be reduced; on the other hand, commitment to the Maastricht Treaty turned the public sector balance into surplus, reducing the debt-to-GDP ratio even in the years before the crisis.

The importance of the public sector is obviously greater than its size. As Pérez (1999) shows, already in the 1980s, the public sector under PSOE administration made an active choice to privilege the interests of the financial sector (through appointment of persons with close links to that sector to official positions in the Finance Ministry, among other things). This protection harmed the industrial sector (in the form of higher financial costs) in such a way that, not only did successive governments reject any attempt to implement an active industrial policy, the process of deindustrialization experienced after entry into the European Economic Community in 1986 was accelerated, paving the way for financial institutions to allocate credit according to other interests, as mentioned earlier. The retreat of the state in relation to the industrial sector also adopted the form of extensive privatizations, particularly from 1993 (see Figure 3).

Figure 3 *Privatizations and parties in government, 1983-2013*

It is perhaps in the analysis of fiscal policies that we can find the most revealing aspects of economic policy-making, and the interests behind it. Worth noting first is that Spain in recent decades has recorded one of the highest top marginal income tax rates in the

OECD, but that its revenues are well below the OECD average. This gap between nominal taxes and effective taxes is due to tax evasion, as well as tax avoidance (BBVA Research, 2013). However, far from implementing tax reforms that would attempt to solve these problems, the expansive phase led to a tax system ever more dependent on revenues coming from the real estate sector, with the aim of gaining further electoral support.

In fact, according to BBVA Research (2013), the increase in tax revenues observed between 1995 and 2007 was mainly cyclical. Estimates from the IMF (2009) measure that an increase in government revenue worth 2.5-3.0 percent of GDP was due to activities linked to the construction or real estate sectors. However, fiscal reforms in 1999 and 2003 resulted in tax cuts, which did not have a negative impact on public revenues because of the partial compensation of extraordinary incomes coming from the real estate bubble (Banco de España, 2017: p. 35). Indeed, as shown by Zack *et al.* (2014: p. 25), official estimates undervalued the effect of asset revaluation in the improvement in tax revenues, without which the structural budget balance would have already shown a deficit by 2004 (see also IMF, 2009: p. 62). Furthermore, the reliance by local governments on revenues from those sectors was such that it reached almost 50 percent of their total revenues by 2005 (Charnock *et al.*, 2014: p. 99)

This was the result of a tax policy followed by both PP and PSOE governments, which had joined an international consensus prioritizing tax cuts: if in 1990 there were 16 brackets and a top marginal rate worth 56 percent in income tax, these figures were at 4 and 43 percent, respectively, in 2008 (Muñoz de Bustillo and Antón, 2015). In addition, the wealth tax was removed, and inheritance taxes were reduced in almost every region of Spain.[3]

Another instance where the public sector adopted an active stance was in the deregulation of various economic sectors, as mentioned earlier. Concerning the construction sector, a new law passed in 1998 facilitated the provision of building permits and allowed for construction almost anywhere in the country. As a consequence, the number of housing starts more than trebled (Chislett, 2013: p. 138). In parallel to this liberalization process, the stock of social housing was reduced, to which must be added the secular policy of tax relief for home-buying. This housing policy was completed with a 'lax environmental policy […] and subsidies for squandering energy and water on inefficient property developments' (López and Rodríguez, 2011a: p. 14).

Meanwhile, the redistributive role of the state was neglected. Between 1996 and 2007, social expenditures oscillated around approximately 20 percent of GDP (the EU-15 average for the same period being 26 percent), which means that the extraordinary revenues were not used to address this issue. Unsurprisingly, the redistributive capacity of the state (measured as the difference in the Gini coefficient before and after state intervention) was the lowest in the EU-15 by the end of the expansive phase (calculated with data from Eurostat, Income and Living Conditions). This was the result of the social policies that were implemented throughout the expansive period. While it is true that some universal features of the Spanish welfare state were expanded, at the same time, cutbacks and privatizations were made as a part of the consolidation process of public expenditures (Rodríguez Cabrero, 2011). Consequently, inequalities remained a problem through the whole period, as we shall discuss next.

7. Distributive struggle

Considering the distribution of income as a particular case in the distribution of power, we can obtain an idea of who won and who lost during the expansive phase. In this sense, the evolution of the labour share of GDP, which decreased from 60.2 percent to 55.3 percent between 1996 and 2007, shows that workers' incomes grew more slowly than that of capital (calculated with data from AMECO). This occurred in a context in which the absolute number of workers reached an all-time high, which points to a distributive issue (with owners and renters appropriating the meagre productivity gains in greater proportion than did workers) and to a decrease in labour bargaining power.[4]

In addition to wages, other sources of working-class income might derive from the welfare state. However, the limitations of the welfare state in Spain are significant, as explained above; thus, unemployment benefits increased on par with average wages, while old-age contributory pensions increased only slightly faster. That was not the case with incomes coming from financial or real estate assets: between 1996 and 2007, these multiplied by 2.6 and 3.8, respectively (Colectivo Ioé, 2017).

Concerning real estate assets, it is important to also mention the evolution of wealth. In addition this will allow us to assess to what extent did the population take part in the speculative bubble as some discourses outline (as we mentioned in the first section). Analysis of secondary residence ownership shows that the bottom 50 percent of the population had scarcely any, while the middle 40 percent possessed less than 20 percent of that type of asset. This means that up to 80 percent of secondary residences were owned by the richest 10 percent of the population – a percentage that remained quite stable throughout the period under study. In other words, if three-quarters of the middle 40 percent owned only a primary residence by 1999, that figure fell to less than 70 percent by 2007. In the case of the Top 1 percent of the population, these figures were at 20 and about 10 percent, respectively, with the percentage of individuals owning three or more dwellings increasing significantly (Martínez-Toledano, 2017).

As shown in Section 2, consumption was a key component of the demand side of economic growth during the expansive phase, while wages, on which consumption depends, were more sluggish (Section 3). The explanation resides in the wealth effect: people used their primary residence as collateral, allowing them to finance their own consumption – even though housing prices were growing so quickly they could hardly be sustained with the current evolution of wages. Extensive debt thus served to guarantee existing levels of consumption, in a trend that has been emulated elsewhere (Soederberg, 2014). It is important to notice that all this was taking place in the country with the highest home-ownership rates in all of Europe (López and Rodríguez, 2011b: p. 50). These high rates had historically been promoted by Francoist governments, and later by financial institutions, real estate agents, and fiscal policies, as well as by 'peer pressure and emulation process[es]' (Sabaté, 2016: p. 110)

These distributive trends are useful for grasping the underpinnings of the 'Spanish miracle'. A significant segment of the population did not enjoy the fruits of growth, thus rejecting the narrative of a generalised party, mentioned at the outset. Some of them are the same people who Alonso *et al.* (2013: p. 72) conclude that have been unaffected by the crisis – not because they are rich or powerful enough to avoid its consequences, but because their problems in covering basic costs date back to the expansive phase. At the other end, the increasing numbers of rich persons acquired more power, in the second European country where the highest percentage of billionaires' wealth is found to be owing to political connections (after Italy; as quoted in Chislett, 2016: p. 73)

8. The crisis that no one saw coming, or the political economic puzzle

Having analysed the components of the economic dynamic and observed certain limitations and weaknesses from which it suffered, we now turn toward determining which agents were at the centre of the overall model, being related to those who benefitted from the situation.

We have observed that two political parties alternatively held the reins of power during the expansive phase. Both had, in their origins, been very distinct (the PP deriving from former Francoist ministers, the PSOE from the 19th century social democratic labour movement). However, as has been the case throughout Europe (see Ryner, 2010), their differences became less and less marked. By the 1980s, for instance, the PSOE had abandoned all attempts to implement typical Keynesian counter-cyclical policies (Pérez, 1999: p. 671), and both parties accepted the monetarist consensus to prioritize inflation as the key goal of economic policy, as well as the 1990s adjustment process on the road to the EMU (Royo, 2009: p. 22; Fernández Rodríguez and Martínez Lucio, 2012: p. 324).

Both the PP and PSOE had incentives to support the existing economic model, since job creation and increasing public revenues (which allowed for popular tax cuts) were important sources of electoral support for both. Interestingly, when the PP lost the elections in 2004, it was not due to growing scepticism over policy-making, but rather to terrorist attacks that occurred just three days before the vote (quickly associated with prior foreign policies implemented by the conservative government -- namely the invasion of Iraq (see Montalvo, 2011)). The new PSOE government applied then a similar economic policy (Fishman, 2012: p. 69). It is no surprise, then, that both parties when in government denied the existence of a real estate bubble and maintained that the economic fundamentals were solid. Both parties had the same disincentive to burst the bubble and risk potential electoral backlash (Royo, 2014b: p. 12), even if this neglect meant leading the country to its worst economic crisis in years. Indeed, there had been warnings against the evolution of Spain’s economy well before 2008 (Royo, 2009: p. 32; Chislett, 2013: p. 169; Ruiz *et al.*, 2016).

There were two additional actors whose importance we mentioned when discussing the expansive phase, and whose influence dates back to the Francoist regime in Spain (Naredo, 2010: p. 15). The first of these was the financial sector. As noted, deregulatory trends did nothing to reduce the market power of a few financial institutions. And that power went beyond markets, given that the policies applied (even by social democratic governments in the 1980s) were designed not to harm their position, even if the industrial sector and the public sector accounts were damaged as a result (Pérez, 1999).

During the expansive phase, both commercial and savings banks increased their profit margins as interest rates dropped and demand for mortgages expanded. However, the peculiar role played by political parties (mainly the two mentioned) in the management of savings banks must be carefully considered (Banco de España, 2017: p. 55).[5]

Due to the power that the parties exerted within savings banks, they were able to finance certain projects, including airports (like those in Ciudad Real or Castellón, which never opened for business) or theme parks that were not sustainable but which were deemed to be potentially positive ways of gaining electoral support (Otero-Iglesias *et al.*, 2016: p. 26). Indeed, the four largest Spanish theme parks (Port Aventura, Isla Mágica, Terra Mítica, and Parque Warner) all followed this model of promotion by public sector institutions or savings banks (Naredo, 2010: p. 21). This alliance between financial and political power proved fruitful for both sides (and savings banks became the object of hard-fought battles for control, not only among parties but even from within; see Rodríguez Acevedo *et al.*, 2011: pp. 112-14).

Besides, the role played by all financial institutions becomes key when considering that housing prices would have not increased so quickly without the willingness of banks to grant larger mortgages (Febrero and Bermejo, 2013: p. 274). Furthermore, as outlined by Ruiz *et al.* (2016: p. 1567), '[l]oan collaterals were being calculated on the basis of overvalued properties and extended to developers that in many cases had set up joint ventures with the originators.' (Chislett, 2013: p. 165).

At this point, a third key actor which had also been decisive well before the expansive phase enters the scene: the building sector. Like the financial sector, this sector was subject to a high degree of concentration, with only six firms (with close historical links to political power) maintaining a dominant position (see Recio *et al.*, 2006; López and Rodríguez, 2010: pp. 323-31).[6] Their power throughout recent decades was not merely because they were positioned at the centre of the growth model, but because they were well-placed to meet public sector demand for large infrastructures (or even public services, once they decided to diversify their mix). During the expansive phase, Spain became the European country with both the longest high-capacity road network and the longest high-speed rail network.[7] Decisions to pursue these infrastructures were functional to the growth model, as López and Rodríguez (2010: pp. 326-30) show, and the same corporations involved also built the cited airports and theme parks that helped the political parties gain electoral support.[8]

We can therefore observe the formation of a triad of actors at the centre of the growth model, and best situated to benefit from it (Figure 4; bold lines). As Charnock *et al.* (2014: p. 97) put it: 'developers, office-building firms, financial institutions, and local governments played a significant rentier role in increasing land prices and intensifying speculation'.

9. Concluding remarks

It is clear from the previous sections that no 'economic miracle' took place in Spain. In fact, the much-admired growth rates and job creation figures had no solid basis and were thus unsustainable. As the years passed, problems suffered by the economy worsened, and these problems can be summarized as follows (Figure 4):

i) Economic growth was fully dependent on the real estate sector. Not only did investment become the centre of the growth pattern, but residential investment was crucial to investments.

ii) The boost in capital stock was due to the increase in fixed investment, while other types of investment (namely, investment in manufacturing, or even in research and development) were more sluggish. In addition to capital stock, the other key element was labour, which experienced a huge increase. Job creation adopted the form of mainly low-wage precarious employment.

iii) In a context of global imbalances inside the EU, with countries that loaned too much to other countries that borrowed too much, Spain was among the latter. Unable to produce the required resources to finance its growth model, Spain had to rely on debt, which was borrowed by its private sector.

iv) The public sector played a key role as facilitator of this process. Tax reforms were implemented to trim taxes, and public revenues were not affected because they were compensated by extraordinary revenues from activities directly linked to the building sector (otherwise, the public sector would have faced deficit).

v) Certain social sectors were particular winners in this process: while wages remained mainly stagnant, profits increased very quickly, which led to a decrease in the labour share of the income distribution. In addition, the wealth effect fuelled housing demand beyond any reasonable limit and sustained the entire model.

Figure 4 *Spanish growth model and the triad of actors*

The expansive phase made Spain a vulnerable economy in several sectors. It suffered from financial fragility, but also from public-sector fragility as revenues became increasingly reliant on the fate of the construction sector. Those vulnerabilities provoked the crisis in a perfect storm, the consequences of which were soon felt by most in the country. Thus, the answer to our initial question of how so radical a change could have taken place so quickly is as follows: because the miracle did not exist.

Concerning the arguments on which we build our thesis, based on our analysis, was it true that Spaniards were living beyond their means? We have shown that many in Spain were forced to resort to debt to finance both their (primary) housing and consumption, but this was frequently because no other alternatives were available (e.g., affordable house rentals or better wages). Thus the assertion is a tough one to sustain. In fact, data on the labour market, on income, and on wealth distribution all show that many people in Spain did not experience the 'party' of the expansive phase (or at least, not as winners).

On the other side, the triad of actors at the centre of the expansive phase remains key to understanding how all this occurred -- or how, in Royo's words, 'institutional degeneration' occurred in the country (Royo, 2014a). Once the crisis hit, people felt swindled, and at that point the slogan 'this isn't a crisis, but a scam' became increasingly popular, as people blamed banks, construction firms, and politicians for their worsening living conditions.

In summary, this paper attempts to explain what happened during the 1996-2007 period in which a strong expansive phase and the imbalances outlined here were inexorably united: none could exist without the others.[9] In this sense, our conclusions differ from alternative accounts that see the main problems in wrong-headed policies, in the greedy behaviour of certain actors, and/or in a generalised and irrational orgy of consumption (see, for instance, De la Dehesa, 2012; Chislett, 2013). On the contrary, employment and GDP growth were the consequence of credit being channelled to the most profitable sectors (i.e., doing what it was meant to do), while regulators trusted markets to organise themselves accordingly. The storm clouds should have come as no surprise, being the mere continuation of an economic trend that could have hardly ended otherwise.

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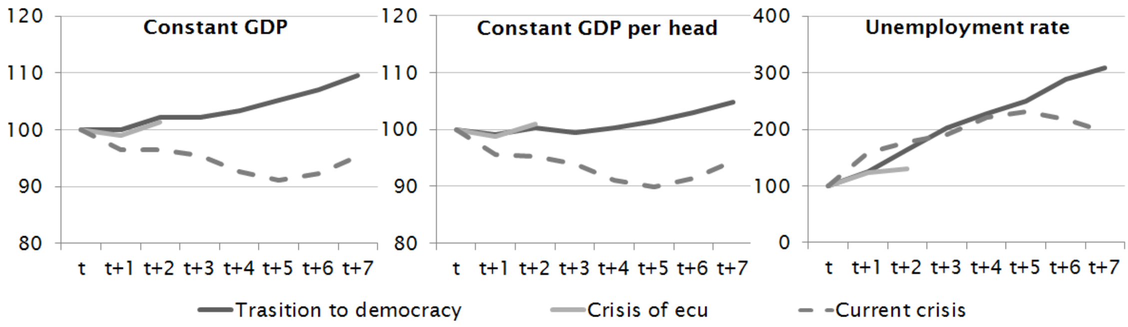
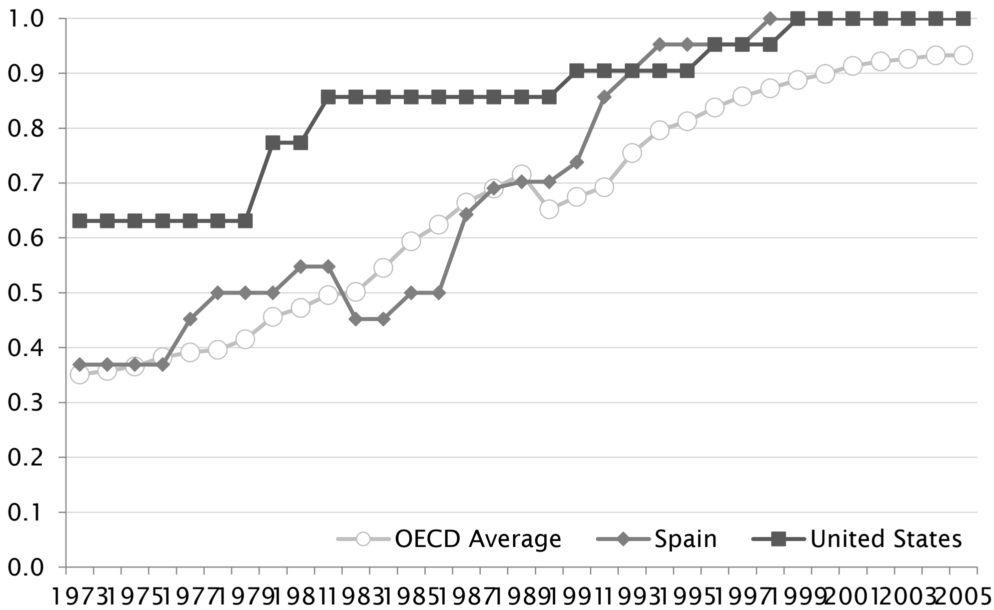
Figures and Table

Figure 1 Impact of economic crises in Spain



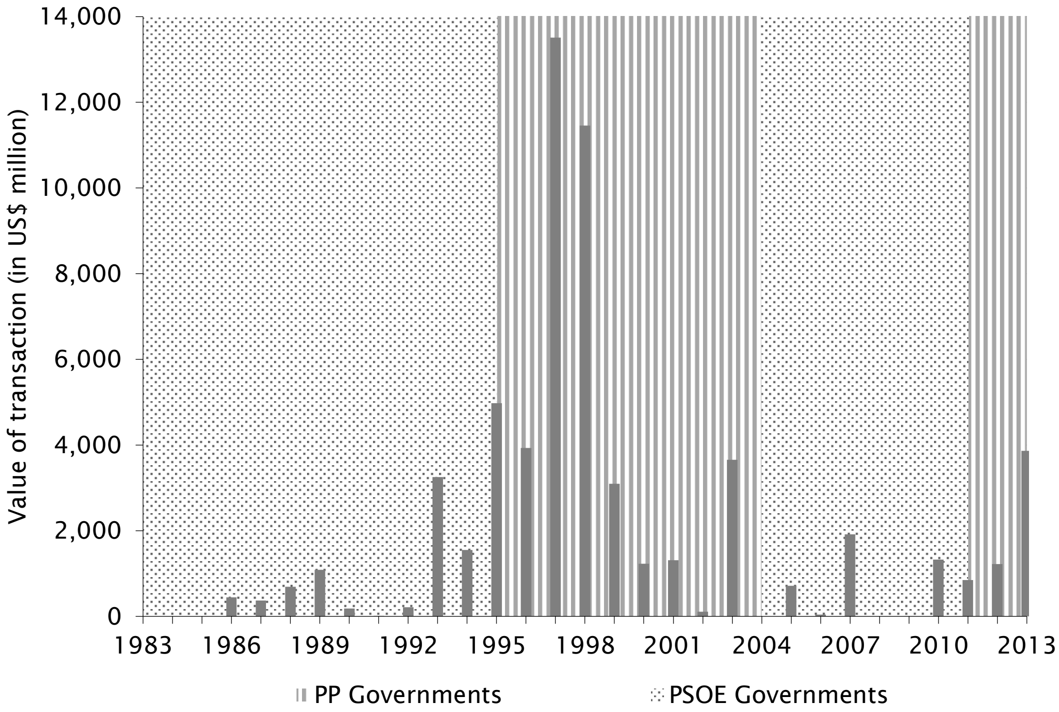
Source: Own elaboration with data from OECD.Stat. We have included the following three episodes of economic turmoil: 1978-1985; 1992-1994; and 2008-2015. In all three cases, t is the starting year. The duration of each of these three episodes is estimated by considering that no crisis has been fully left behind until the economy reaches a GDP growth rate of 2 percent or above for two years in a row.

Figure 2 Deregulation index in the financial sector, 1973-2005



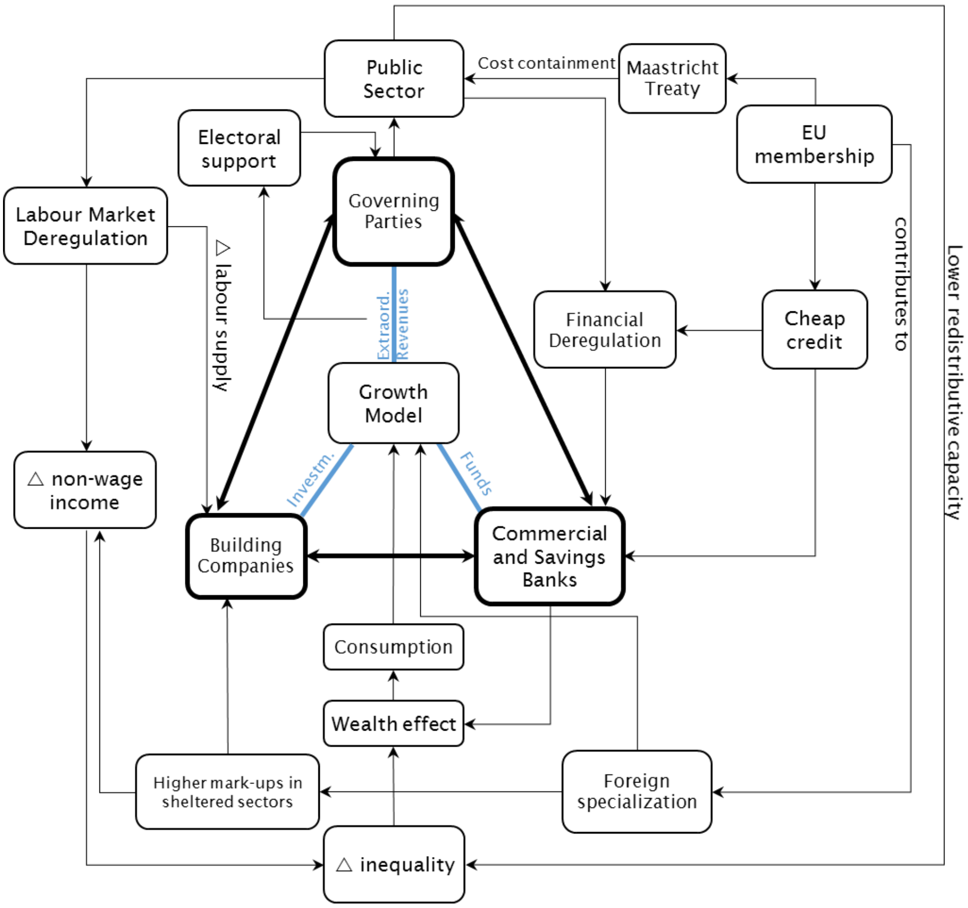
Source: Abiad *et al*. (2008). The index increases with deregulation; thus, the higher the index, the more deregulated the financial sector.

Figure 3 Privatizations and parties in government, 1983-2013



Source: Own elaboration with data from the Privatization Barometer.

Figure 4 Spanish growth model and the triad of actors



Source: Own elaboration.

Table 1 Supply side growth (1996-2007), yearly average

Y	*Lp*	*Y/Lp*	*K*	*K/Lp*	*K/Y*
3.7	3.3	0.4	4.1	0.8	0.4

Source: Own elaboration with data from INE (Spanish Statistical Office), National Accounts.

Notes

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[1] It is interesting to note that this was the third 'construction boom' in Spain's modern history, and all have been related to tourism, and all have led to 'the disproportionate development of related branches of production' (Charnock *et al.*, 2014: p. 48). These historical developments are also closely related to (and conditioned by) the delay in Spain's industrialization and the promotion of the housing market by the Francoist governments, a process of specialization that took the form of 'unfinished Fordism', along with (among other things) clear subordination of labour to capital in economic relations (Toharia, 1986; see also López and Rodríguez, 2010: Ch. 3).

[2] In any case, concerning competitiveness, it is worth noting that according to data from the World Bank's World Integrated Trade Solution, Spain's share of total world exports remained stable through those years, at around 2% (see also Banco de España, 2017: p. 32), while those of Germany, France, and the UK declined in a context where China increased its share threefold. This would be a clear case of Kaldor's paradox.

[3] As an example of the ideological convergence of the PP and PSOE concerning the public sector, it is worth mentioning that José Luis Rodriguez Zapatero, 'the would-be premier of the social democratic government in the period 2004–2011, [declared in 2000] 'I think that the idea of lowering taxes is leftist' (quoted in Muñoz de Bustillo and Antón, 2015: p. 497).

[4] This is a direct consequence of the subordination mentioned in Note 1, and is one of the features that Toharia (1986) mentions in his description of Spain's unfinished Fordism.

[5] The degree of interventionism by the public sector in the savings banks has been historically high. See Rodríguez Acevedo *et al.* (2011: pp. 107-10) for a detailed historical explanation.

[6] These firms are: ACS, Acciona, Ferrovial, Fomento de Construcciones, OHL and Sacyr Vallehermoso. On the shoulders of the state, these same companies have become international champions in infrastructure building (Government of Spain, 2014). Something similar had occurred with other Spanish firms -- many of which were the result of the extensive privatization mentioned before -- that have gained international presence thanks to a prior, proactive role played by the state (e.g., Endesa, Repsol, Iberdrola, or Union Fenosa) (Charnock

et al., 2014: pp. 64, 76). Indeed, the state used the extra revenues obtained from the real estate sector and construction (among other things) to support the international expansion of all these companies under a privileged tax regime that allowed them to offset 30 percent of any foreign company acquisition against taxes (*Íbid.*).

[7] The adequacy of the investment decisions leading to these networks is not exempt from controversy. For example, in 2015 Germany criticized the (still) 'excessive expenditure on high-speed rail' in a context of many stations lacking significant traffic (Romero, 2015).

[8] The link between savings banks and the construction sector became even more explicit in the cases of some savings banks creating their own property development firms (Rodríguez Acevedo *et al.*, 2011: p. 117).

[9] These imbalances were not exclusive to Spain, as other EMU countries (such as Ireland) experienced similar trends, with similar results, as a consequence of financial markets underestimating the inherent risks (Banco de España, 2017: p. 33). For more on the case of Ireland (and its similarities and differences with Spain), see Dellepiane-Avellaneda *et al.* (2013) and Ó Riain (2013).