The ‘Spanish miracle’ that never was

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At the beginning of the current crisis, there was a debate in the economics profession concerning the policies that countries should adopt in order to grow again. Those debates hinged on two prominent positions. On the one hand, there were those economists who – in an apparent endorsement of Mariano Rajoy’s statement that "We have lived beyond our own means” – argued for austerity policies. This was the position of the IMF and the European Commission, which considered that only through austerity could countries in crisis recover (see, for instance, European Commission, 2011; and Weisbrot and Jorgensen, 2013, for an overview of IMF recommendations to EU countries)[1]. On the other hand, there were those who argued for expansive policies to enable countries under strain to re-establish economic growth. Authors including Lapavitsas and Munevar (2014) for the Greek case and Navarro, Torres and Garzón (2011) for Spain, have attempted to show the inadequacies of austerity in the crisis context.

To ascertain the appropriate medicine for a sick economy we need first to correctly diagnose the sickness. This chapter will attempt to do so in six sections that follow. Section one introduces the political economy of the so-called "Spanish miracle". Section two analyses the pattern of growth followed by Spain, both from the supply-side and the demand-side. Section three focuses on the role of Spain in the European division of labour, in order to understand some of the contradictions in its economic model. The fourth and the fifth sections are devoted to the roles played respectively by the financial sector and the public sector, and the sixth section provides a general view of how income was distributed throughout the period. Finally, the chapter considers the impact and consequences of the crisis and offers some concluding remarks.

The political economy of the ‘Spanish miracle’

Spain was, before the crisis, widely admired by economists and others for embodying what was termed the ‘Spanish miracle’[2]. "España va bien" (Spain is doing well) was the well-known description given by José María Aznar, the Prime Minister between 1996 and 2004. But, was it so? Can we speak of a miracle? Before we focus on the economic

[1] Muñoz de Bustillo (2014) provides an excellent analysis of the theory and evidence of the so-called “myth of expansionary austerity”.

[2] Liberal economists and those linked to the parties in government, tended to base this statement on the high rates of economic growth in a context of the “Great Moderation” (see, for example, Bernaldo and Martínez, 2005). Moreover, within the European Commission Spain was presented in the mid-2000s as a model to follow (see the newspaper article “El milagro económico español”, *El país*, 22 March 2007).

variables that will allow us to answer this question, we will first consider the political-economic aspects of the expansive phase (1995-2007), which provides the framework inside which the policy-making decisions were made. Three sets of interrelated actors were central to this story: the two major political parties, the financial sector and the construction sector.

Two parties, the conservative PP (Partido Popular) and the social democratic PSOE (Partido Socialista Obrero Español), have governed the country for almost all of its democratic period (with just one exception[3]). The differences between them have always been notable. The PSOE, formed in 1879, has always been a member of the Second International and the representative of social democracy in Spain. The PP, in contrast, was created in 1976 by former Francoist ministers, and is the main conservative party in the country. However, just as in the rest of Europe, as social democracy chose a road of "accommodation to global finance" under the Third Way (Ryner, 2010), the differences in economic policy-making became less marked. As early as the 1980s the PSOE had abandoned any attempt to implement Keynesian countercyclical policies (Pérez, 1999: 671) and both the PP and the PSOE accepted the monetarist consensus to prioritize inflation as the key economic policy goal and later the adjustment process during the 1990s on the road towards European Monetary Union. Particularly noteworthy in the 1995-2007 period was a political consensus around the centrality of the construction sector. When in power, both parties refused to accept the reality of a real-estate bubble, their denial incentivised by on-going rapid job creation and extraordinary public revenues that allowed for popular tax cuts throughout the period.

The financial sector of Spain has traditionally been made up of three types of institution: commercial banks, savings banks and credit unions. The first two account for over 95 percent of deposits in Spain. Before the 1980s, savings banks – conceived as quasi-public institutions – specialized in the household sector whereas banks specialized in the corporate sector, but these differences have since been eroded. The degree of concentration has traditionally been high: five institutions (three commercial and two savings banks) owned on average half the assets of the whole financial sector and this concentration was not reduced by the neoliberal reforms introduced in the 1980s. The power of these institutions was such that the policies applied even by social democratic governments were designed not to harm their position, even if the upshot was damage to the industrial and public sectors (Pérez, 1999). During the expansive phase of 1995-2007, both commercial and savings banks increased their profit margins as interest rates went down as a consequence of EU membership and demand for mortgages was buoyant. The peculiar role played by the two political parties in the management of savings banks was also significant, leading to the financing of

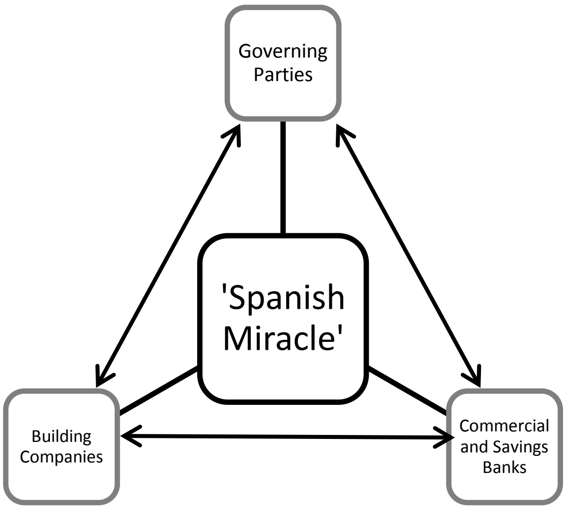
[3] Only during the first years of democracy in Spain can we find another governing party, UCD, Unión de Centro Democrático, but since 1982, PSOE's governments have alternated with PP governments, sometimes with the support of other regional parties, namely from Catalonia and the Basque Country.

unsustainable 'white elephant' projects including airports and amusement parks; moves apparently aimed at electoral gain.[4]

The third key actor during this expansive phase was the construction sector, which was at the centre of a model driven by rapid growth in residential property and large-scale public infrastructure projects. A group formed by six construction firms with close links to political power has long dominated the sector (see Recio, de Alós-Moner and Olivares, 2006; López and Rodríguez, 2010: 323-331).[5] Those firms benefitted from investment in infrastructure but also from residential investment as it became the main growth engine.

This triangle of actors (see Figure 1) was central to the growth model that constituted the so-called 'Spanish miracle' and able to successfully block alternative paths. They did so with the apparent endorsement of an electorate that felt the wealth effects of this ostensible miracle. However, as we will see below, the key driver of that effect was credit driven consumption.

Figure 1. The actors at the centre of the 'Spanish miracle'.



An extensive pattern of growth

The Spanish growth model can be usefully analysed through both the supply and the demand side. The supply side of an economy refers to 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. There are two ways in which an

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[4] There are many examples, but the most widely known are those related to the airports in Ciudad Real and Castellón, as well as the amusement park "Terra Mítica" in Alicante.
[5] These firms are: ACS, Acciona, Ferrovial, Fomento de Construcciones, OHL and Sacyr Vallehermoso. It is worth noting that, on the shoulders of the state, these same companies have become international champions in infrastructure building (Government of Spain, 2014).

economy might grow: increased efficiency (measured as each factor's productivity) or augmenting the volume of factors in use.

Table 1. Yearly average growth, several variables. 1996-2007.

	Y	*L*	*Y/L*	*K*	*K/L*	*K/Y*
1996-2007	3.7	3.3	0.4	4.1	0.8	0.4
1996-2000	4.1	3.9	0.2	3.6	-0.3	-0.5
2001-2007	3.4	2.9	0.5	4.5	1.5	1.0

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

Table 1 shows that economic growth (Y) was high throughout the expansive phase: for instance, whereas in the 1996-2007 period it was 3.7 percent, the corresponding figure for the euro area was 2.3 percent. This growth was based on the accumulation of factors (either work, L, measured in persons, or capital, K), rather than in the increase in their productivity. In contrast, labour productivity (Y/L) grew at very low rates in both periods. Considering labour productivity as a relationship between K/L, which shows how productive factors have been combined, and K/Y, which is the degree of capitalization of production, we can observe that between 1996 and 2000 employment grew faster than capital, leading to a decrease in the capitalization of the economy. However, this trend was reversed during the period after 2001, when the use of capital grew faster than the use of labour as means of production and the economy was highly capitalized. Capital accumulation reached a rate of 4.5 percent per year in the period 2001-2007, while the productivity of that capital, as seen in the inverse of the ratio K/Y, was negative in the same period, which means that employers had diminishing returns, in terms of value added, per each unit of capital used in the production process.

As regards the use of factors, there was an increase in the use of labour in Spain that was greater than in other countries in the euro zone, but we can also observe a greater increase in residential capital than in productive capital, reflecting the construction oriented growth model. Data from the Spanish Statistical Office (INE) illustrates the increase in the share of the construction sector in the whole economy, such that from 1995 to 2007, its share of the GDP in real terms went from 8.8 percent to 12.3. Data from the European Commission's Annual Macro-economic data-base (AMECO) shows that in 2007 the share of construction in total value added was much higher in Spain (11.2 percent) than the equivalent in France (6.1), Germany (3.9), Italy (6.0) or the United Kingdom (6.9). The growth in this sector was due to: 1) the public policies that were implemented; 2) the inflow of a new population attracted to a labour-intensive economy (that, in turn, demanded homes to live in); 3) the purchase of apartments (by Spaniards and Europeans) on the Spanish coast; 4) improved financing conditions linked to the euro; and 5) the existence of a speculative bubble, that drained money from other sectors.

At the same time as this boom, industrial and energy sectors declined; down from 20.3 to 15.6 in 1995-2007 period. And within industry, high-tech manufacturing was well below than the EU average, and its weight declined during the expansion period. In 2007, Spain invested 1.23 percent of its GDP in R&D while the average in the euro area was 1.81 percent and patent applications to the European Patent Office per million inhabitants made by Spanish researchers were 30.95, compared with 146.88 in the euro area (all data from Eurostat). In short, Spain became a European leader in the construction sector, but to the detriment of other sectors.

This pattern of specialization helps explain the evolution of productivity. On the one hand, while productivity was greater in industry and agriculture, these were sectors whose importance diminished during the boom years. On the other hand, as Mateo and Montanyà (2014) show with data from AMECO, of the 12 years between 1996 and 2007 (inclusive), only in three did construction contribute positively to the increase in productivity in the economy. Considering the economic weight of that sector, it is no surprise how overall productivity evolved.

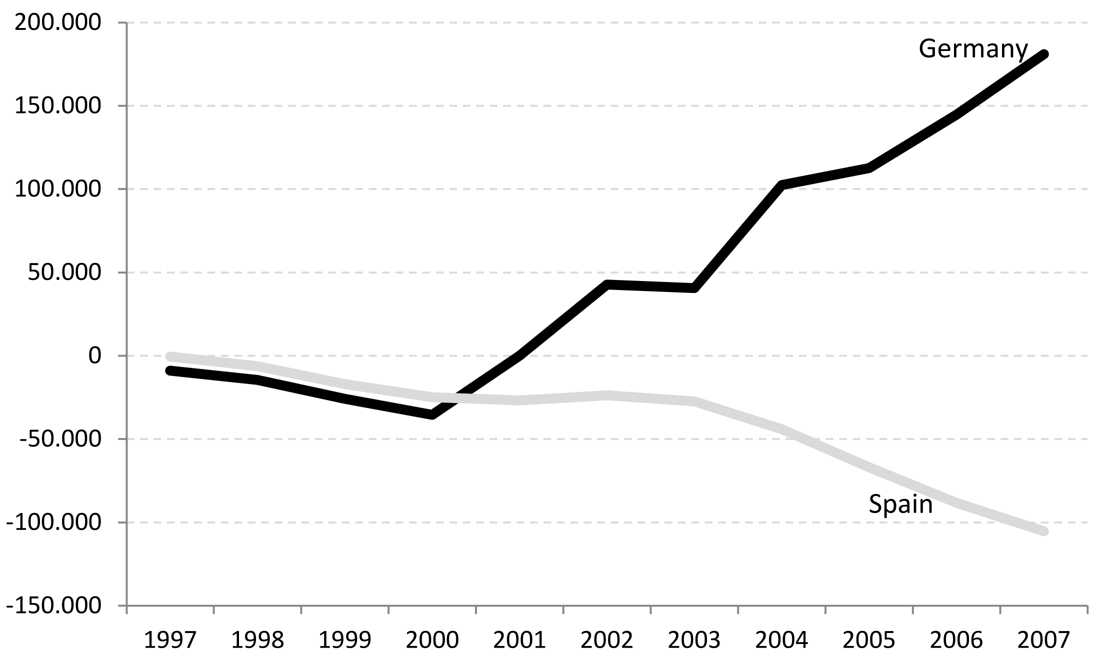
Regarding demand, it should be emphasised that domestic demand was key to understanding the growth model adopted by Spain. Both consumption and investment played an important role in the macroeconomic development of the economy, but concretely the performance of investment was outstanding. According to data from INE, Gross Fixed Capital Formation (GFCF) reached yearly growth rates that averaged 6.1 percent in the whole period, and 7.2 percent between 1996 and 2000. This is closely related to the rate at which the economy accumulated capital, as noted above. As a consequence, this part of domestic demand represented 21.4 percent of GDP as of 1996 and 30.7 percent in 2007. In accordance with the foregoing, the share of residential investment was substantial and grew during the period: in 1996 it accounted for 32.6 percent of investment and 40 percent in 2007. On the other hand, investment in machinery accounted for 21.3 percent in 1996 and 16 percent in 2007 (all data from FBBVA, 2014). In accord with these trends, prices in this sector increased much more than they did in the rest of the economy (Mateo and Montanyà 2014).

The role of Spain in the European division of labour

As consumption grew in Spain, the current account deficit increased due to increasing imports. Those deficits in the balance of goods had been traditionally financed by the surplus in the balance of services, particularly due to tourism. However, from the end of the 1990s the surplus in services were increasingly inadequate to compensate as consumption increased more quickly and tourism lost its dynamism due to increasing competition. A net lender in 1997, Spain had become a net borrower by 2007, with a net borrowing position worth 9.6 percent of GDP (CES, 2012). This became an important source of vulnerability. Two main factors account for this evolution. On the one hand, increasing domestic demand driven by cheap credit and on the other hand, a weak position in the European division of labour. Spain has traditionally had a lower share of exports in its GDP compared to its European neighbours. In addition, the Spanish economy specialises in goods with lower technological content (as a consequence of the growth model we have discussed above) that are less competitive. Indeed, in the case of intra-industry trade (which amounts to up to 70 percent of all trade), it is notable that the economy imports components that are more advanced than those that it exports, negatively contributing to the current account balance of the economy.

Over 60 percent of Spain's trade takes place with other EU partners (a figure which is similar for other EU countries). Following Luengo and Álvarez (2011) we can say that Continental and Anglo-Saxon countries experienced trade surpluses in the years under study, whereas Southern and Enlargement countries experienced structural trade deficits. According to their analysis, enlargements, first towards the South of Europe, and then towards Eastern Europe, led to the formation of a complex and diverse economic structure that paved the way for the creation of imbalances, both within and between countries. To offer one example, consider the current account balance of Spain and Germany during these years. The difference between them (see Graph 1) is the result of different patterns of specialisation, with Germany specialising in goods with higher value added and greater technological content (Luengo and Álvarez, 2011; Garzón, 2013).

Graph 1. Current Account Balance of Germany and Spain, 1997-2007.

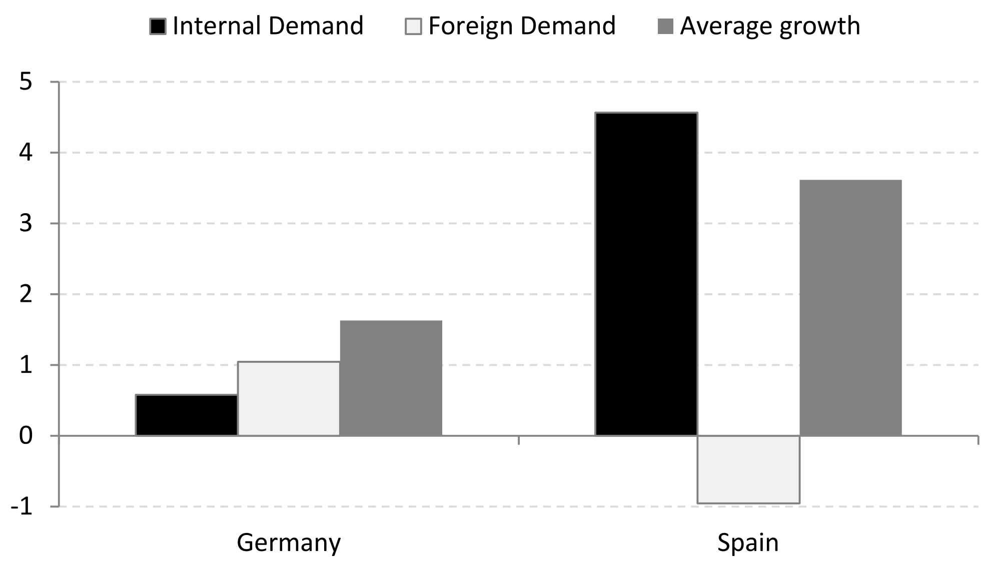


Source: Own elaboration with data from Eurostat.

If trade could not be used to finance Spain's external imbalances, a new source had to be found. Before monetary union, devaluation of the national currency (the former peseta) was a viable way to balance the economy. Within that union financing relied increasingly on direct investment and borrowing; either issuing financial instruments or applying for loans. Membership of EMU helped Spain to raise those funds. Spain's share of global inward FDI stock almost tripled between the 1980s and the 1990s[6], but since the mid-1990s the main source of financing has been from borrowing and issuing financial instruments (Garzón, 2013). Since the end 1990s investment has relied increasingly on private debt (Garzón 2014), while public debt fell. By 2009, total debt was estimated at 502% percent of GDP (Lapavitsas *et. al.*, 2010). Thirteen percent of this was held by the public sector, 17 percent by households, and the remaining 70 percent by corporations, both financial (31 percent) and non-financial (39 percent). Data from the Bank of Spain (taken from Sanabria and Medialdea, 2014) suggests that private debt was just under 90 percent of GDP in 1994 but 311.5 percent in 2007.

Spain was among those countries that based their growth model on debt in order to solve the dilemma of having an economy in which internal demand is crucial but wages are relatively stagnant. As we can see in Graph 2, there is a stark difference between the path followed by Germany (an export-led country) and Spain (a debt-led country) (Álvarez et al., 2013). In Spain high rates of investment were financed with funds from abroad, in a context of low interest rates. Debt-led growth was increasingly dependent on increasing housing prices – a bubble – which sooner or later would burst.

Graph 2. Contribution to growth of internal and foreign demand, 2000-2007



Source: Álvarez et al. (2013: Ch. 4).

Channelling the funds: the financial sector

While the funds that made the 'Spanish miracle' possible came from abroad the domestic financial institutions discussed above were key in channelling those funds to certain sectors. Concretely, "Spanish banks […] were borrowing over a quarter of their

[6] Data extracted from UNCTADstat (http://unctadstat.unctad.org/EN/) in 2013.

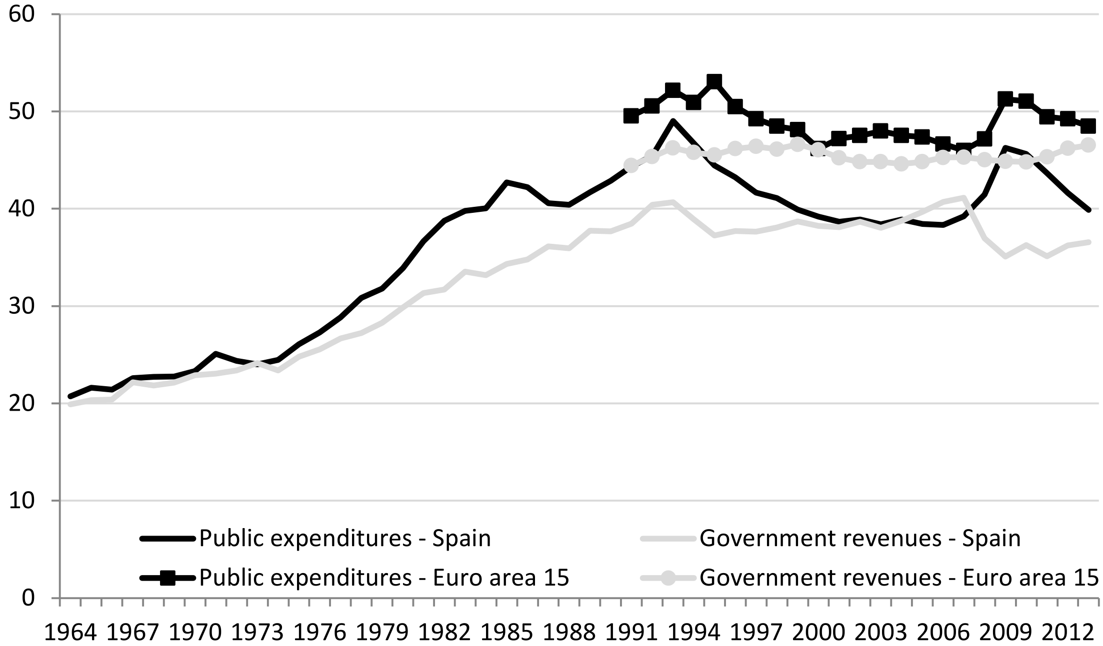
balance sheets in the interbank lending market from their German and Dutch competitors" (Fernández-Villaverde and Ohanian, 2010: 10). Spain has not been an exception in the global trend of financialization. Between 1985 and 2000, financial assets grew from 424 to 700 percent of GDP (Garrido, 2013). Financial institutions increased credit provision at an annual rate that reached 30 percent per year at the end of the expansive phase (data from INE and Bank of Spain), much of it funded by borrowing in international markets (given that savings were low in Spain during the period). This increase in credit went hand in hand with a rapid increase in the number of bank offices and employees (particularly in the case of savings banks).

While savings banks were supposed to contribute to the implementation of the industrial policy designed by the government, the absence of any such policy allowed them to allocate credit according to other interests (Santos Castroviejo, 2013). Credit from abroad was consequently channelled by both commercial and savings banks to the aforementioned construction and real estate sectors (Molero, 2014). When the crisis started these were the sectors in which credit delinquency was highest. The financial sector was therefore completely functional to the development of the pattern of specialisation. Government deregulation (which increased notably during the period, see Abiad *et al.*, 2008) contributed to this by making financial institutions less reluctant to lend, particularly in the case of savings banks. This deregulation process, however, did not reduce concentration in the finance sector. By 2008, the asset base of Banco Santander (the biggest bank) was only 20 percent less than that of JPMorgan Chase (the biggest US bank), with BBVA, the second financial institution in Spain, not far behind (Fernández-Villaverde and Ohanian, 2010: 19).

Meanwhile, the public sector….

The public sector played a crucial role in the processes described to this point. During the democratic period, the public sector grew, but never reached the EMU average. In the case of expenditures, Spain got closer to that average, but in the case of revenues, the gap was never lower than four percentage points (see Graph 4).

Graph 3. Public sector expenditures and revenues, 1964-2013.



Source: Own elaboration with data from Eurostat.

As early as the 1980s the PSOE government, made an active choice to privilege the interests of the financial sector, among other things, through the appointment of government officials in the Ministry of Finance with close links to that sector (Pérez 1999). This protection harmed the industrial sector (in the form of higher financial costs) in such a way that not only did governments reject any attempt to implement an active industrial policy, but contributed to the de-industrialization process that the economy experienced after entering the European Economic Community in 1986. The retreat of the state was reflected also in extensive privatizations from the early 1990s. More generally, both the PP and the PSOE sought to reduce the public sector as a matter of policy and this was linked in part at least to efforts to meet the Maastricht convergence criteria, which required a reduction in public deficit and debt. It is worth noting that – contrary to certain myths with respect to the profligacy of periphery governments – during these years, public expenditures as a percentage of GDP fell even below the level of government revenues and Spain became one of the EU countries with the lowest public debt to GDP ratio.

As to tax revenues (where, as Graph 4 shows, the gap with the euro area is higher) nominal tax rates in Spain are among the highest in the European Union, but effective taxes are well below the average, due to tax avoidance and evasion (BBVA Research, 2013; Lagares, M. *et al*., 2014). Tax reforms introduced during the expansive phase did nothing to address this problem; on the contrary, it made the tax system more dependent on revenue from the real estate and construction sectors. Indeed, increases in government revenue during the expansive phase were due to activities linked to that sector and tax cuts implemented in 1999 and 2003 were possible only because of such revenue (Zack *et al*. 2013). The shared desire of the two parties to cut taxes in the period was indicative of the abovementioned (neoliberal) ideological convergence.[7] A reliance on construction for revenue created incentives for the authorities to remove barriers to the expansion of the sector. For instance, the labour market reform in 1997 reduced employers' layoff costs (Ruiz Galacho, 2006: 17; see also Molero and Murillo, 2014: 4 and ff.), while in 1998 new legislation granted easier access to building permits and permitted construction almost anywhere. In parallel, the stock of public housing was reduced, which was offset by tax relief for home-buying and a "lax environmental policy" granted "subsidies for squandering energy and water on inefficient property developments" (López and Rodríguez, 2011b: 14).

In short, the increase in revenues during the expansive phase was not used to improve or reinforce a welfare state that was below EU-15 standards. Although some universal features were expanded simultaneous cutbacks and privatizations were applied as a part of the consolidation process of public expenditures (Rodríguez Cabrero, 2011; Moreno, 2012). Retrenchment was applied in Spain before it had developed a comprehensive and generous welfare state (Muñoz de Bustillo and Antón 2014) with significant social consequences.

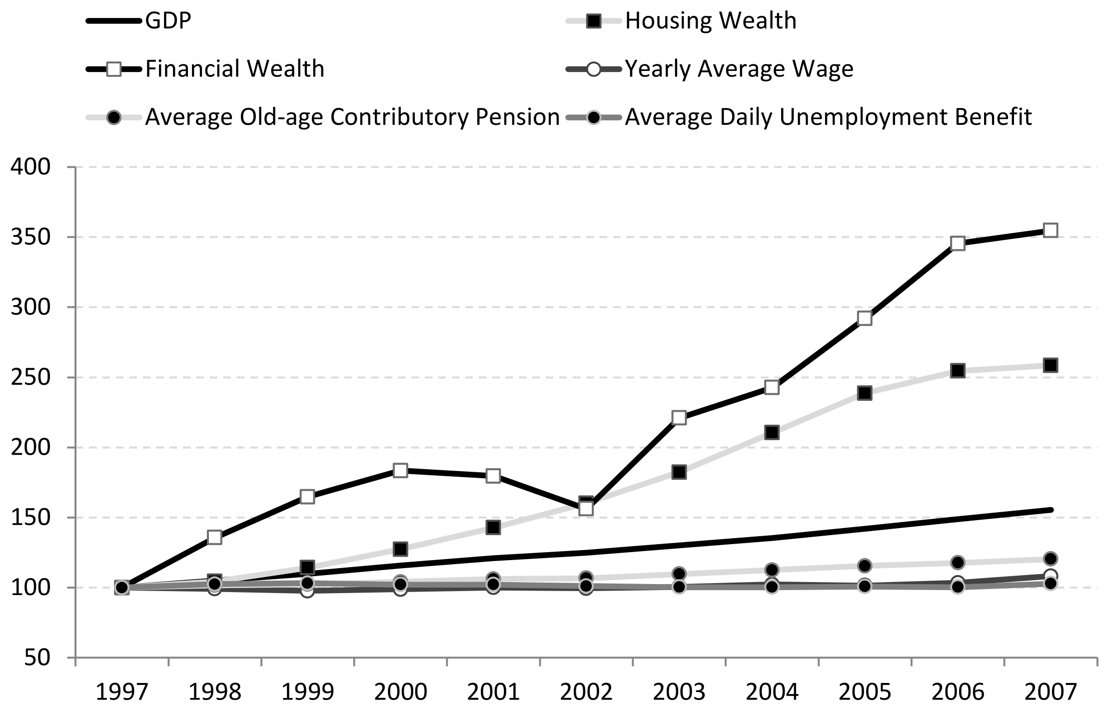
Who owns what?

Although one out of three jobs created in Europe during the period under study were created in Spain, those jobs were mainly low-skilled (attracting both migrants and early school leavers), with the vast majority closely linked to construction and real estate. Such jobs were precarious and often temporary jobs – one third of contracts took this form during the expansive phase (Recio and Banyuls, 2004) – where average wages were on average two-thirds of permanent employees (Murillo, 2008). Therefore, despite the narrative of prosperity associated with the years of economic growth, the reality of working poor remained. In 2004 the in-work at-risk-of-poverty rate was 10.8, while in 2007 it was 10.2 (and it increased thereafter) (Eurostat) and the incidence of such poverty was 2.3 percentage points higher than in the EU-15.

While real wages grew slowly – even below the low rates of productivity growth – other sources of income increased much faster, as shown in Graph 5. In particular, the value of financial assets and real-estate assets increased by 150 percent and 250 percent, respectively. It is not surprising then that the share of income obtained by the richest 1% of the population increased from 8.3 percent of national income in 1996 to 12.7 per cent in 2006.[8]

[7] As an example of the ideological convergence of the PP and the 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] 'I think that the idea of lowering taxes is leftist'" (quoted in Muñoz de Bustillo and Antón, 2014 from *El País*, 1 September 2000).
[8] World Wealth & Income Database, wid.world, 1981-2012

Graph 4. GDP and different sources of income. Spain, 1997-2007.



Source: Own elaboration with data from Barómetro Social de España, www.barometrosocial.es.

The implications of these trends for understanding the political economy of the 'Spanish miracle' are not trivial. As explained in section 2, the growth model was dependent, from the demand side, on consumption and investment, but those rates of consumption growth can hardly be sustained with such meagre wage growth alone. Thus, in the country with the highest home-ownership rate in Europe (López and Rodríguez, 2011a:50) individuals used their homes as collateral to finance consumption. This was possible only because of increasing house prices. Such a context permitted easy access to debt, which became a substitute for welfare in a process that has been paralleled elsewhere (see, for example, Soederberg, 2014; Montgomerie (coord.), 2014). As states retreat in the provision of social protection, debt enters the scene; in the case of Spain, through the real-estate sector. As elsewhere, indebtedness was a necessary solution to fuel the economic engine (Lavoie and Stockhammer 2013; García 2014) given that the incomes of the majority of the population were not enough to drive the internal demand required for growth in the context of Spain's position in the international – especially European – context.

The 'miracle' was a mirage

For Spain, the crisis moment arose when the debt stopped renewing itself. In the case of Spain, the credit crunch was preceded by two exogenous factors: on the one hand, the bankruptcy of Lehman Brothers in 2008 dried up international credit channels; on the other, the increase in interest rates (from 0.25% to 4.25% in July 2008), made the situation harder. However, the excessive reliance of the model on debt underpinned the crisis (Sanabria and Medialdea, 2016: 205). When the financial sources of the current growth model failed, its engine, the construction sector, was heavily damaged. The collapse of this sector contributed to the largest destruction of jobs in the euro zone: 3.4 million between 2007 and 2013 (and the figure in 2015 is still 2.7 million lower than it was then).

The broader social and economic consequences of the crisis have been enormous. The public accounts were hit hard. Of all EU-28 countries Spain's revenues experienced the greatest fall at the onset of the crisis: 6 percentage points of GDP. And in 2015, public revenues are still 2.7 points below the 2007 level and almost 7 points below the EU-28 average). While there was a surplus in the public sector accounts worth 2 percent of GDP by 2007, in 2009 it had become an 11 percent deficit and is still 5.1 percent in 2015 (data from Eurostat). This collapse in the public finances was the result of a twofold process. First, public expenditures went up as a consequence of automatic stabilizers (particularly due to the boost in unemployment-benefits recipients), bank bailouts and, to a lesser extent, the implementation of expansionary policies by the PSOE at the beginning of the crisis. Second, public revenues simply sank due to the aforementioned reliance on the (now ailing) construction sector.

At the same time, an "austerity" program was introduced that made matters worse. While endorsed by the government, this program, whose measures were gradually toughened, was also the result of pressures coming from the EU: first in the form of (stringent) recommendations and later – when the government encountered difficulties in refinancing its debt in the financial markets – as a condition for European Central Bank (ECB) intervention (Pavolini *et al.*, 2016). The program hinged upon three main goals (all them based in supply-side economics). First, to decrease labour costs to improve the country's competitiveness and facilitate deleveraging (so-called "internal devaluation"). Second, to reduce the size of the public sector, thereby mitigating the role of the state in the economy (which, in an inversion of the actual causality, was blamed for the crisis through the "fiscal crisis"). And, third, to replace welfare with workfare (which, implicitly, and sometimes explicitly, presents the unemployed and those in need of social protection as responsible for their situation).

With respect to internal devaluation, both the PSOE and the PP passed labour market reforms (notably, in 2010 and 2012). The reforms have, inter alia, made dismissal cheaper (from 45 days per year worked to 33 days per year) and easier; promoted the decentralization of collective bargaining (by introducing the opting out clause for firms not to apply sectoral collective agreements); and reduced unemployment benefits (after the sixth month) (Banyuls and Recio, 2015). These reforms paralleled the huge increase in unemployment.

Between 2007 and 2009 alone, those receiving unemployment-benefit doubled, those receiving social assistance increased by 50 percent and those claiming old-age pensions increased by 3 percent (OECD). The government tried to curb the subsequent increase in public expenditures through measures that included: wage freezes and layoffs in the public sector; a (gradual) increase in retirement age from 65 to 67 years old; a rise in the years of contribution required to access the maximum old-age pension (from 35 to 37); the augmentation of the years used to calculate pensions (from the last 15 years to the last 25 years); a hardening in the requirements to access voluntary pre-retirement; since 2013, the retirement pension system is a defined-contribution system, instead of a defined-benefit system; the reduction in medicines that are eligible for public subsidy; the outsourcing of several services in the healthcare sector and the erosion of its universalism (by restricting the access of undocumented immigrants); the rise in the price of childcare services; the reduction or elimination of certain educational services (such as those focused on students with special needs); the increase in the pupil/teacher ratio; the rise in tuition fees and the reduction in grants; and privatizations in several sectors (like airports or lotteries) (see Banyuls and Recio, 2015). Finally, the parliamentary support of both the PP and the PSOE allowed for a reform of the Constitution in order to prioritize the payment of debt over any other goal.

The consequences of these adjustment programs have been grave. After an initial increase in annual wages between 2007 and 2009 – which was mainly due to the destruction of temporary employment linked to construction – in 2014 they were still 7 percent lower than in 2009 in real terms (OECD). The in-work at-risk-of-poverty rate was in 2015 higher than ever (13.1 percent compared to 10.2 percent in 2007). This risk for the population as a whole was 28.6 in 2015 (after it decreased 0.6 points from the previous year) and 23.3 in 2007. Finally, inequality, measured through the Gini coefficient, is now at the same levels it was in the mid-1990s, after rising from 0.319 to 0.346 in the 2007-2015 period. According to Eurostat (where we have taken all these data from), Spain was in 2014 (the last year with available comparable data) the most unequal EU-15 country, and the sixth most unequal EU-28 country. Mortgage foreclosures increased from 25,943 in 2007 to a peak of 93,636 in 2010 (and in 2015 there were still 68,135) (data from the General Council of the Judiciary). Data from the Bank of Spain (collated from financial institutions) shows that 110,140 repossessions of foreclosed dwellings took place between 2012 and 2014 (the only period currently available).

Meanwhile, the government facilitated the restructuring of the financial sector, promoting a greater concentration and transforming savings banks into commercial banks, as well as bailing them out when necessary (either by acquiring their bad debts either offering blanket guarantees). Construction firms in turn, underwent also a concentration process, but given that the sector was experiencing problems, the main actors chose to reinforce their internationalization strategy.

From 2014 the Spanish economy began to grow again. The economy benefitted from the ECB's low-interest-rate policy, the decrease in international prices of energy and a push from the public sector in the electoral year of 2015 (including a cut in taxes and an increase in expenditures). As a result, exports are now more dynamic than they used to be. However, if inflation rates increase again (as data at the time or writing suggested they were), it will affect real wages. And if the ECB increases interest rates to curb inflationary pressures, it will damage consumption, which once again will only be supported by debt. Moreover, the kind of employment that has been created and the increase in inequality poses a permanent threat to internal-demand-driven economic growth, not to mention poverty and unemployment levels, which are well above their pre-crisis levels. At the same time, given the kind of specialization that we have shown above, the Spanish share in world exports is unlikely to substantially increase. Thus, given the nature of the growth model described in this chapter and the slight changes that model has experience, we should be sceptical with respect to the strength and length of the recent 'recovery'[9].

Concluding remarks

This chapter has sought to provide a clear picture of how the Spanish economy has evolved, why it was particularly vulnerable to crisis, and the consequences of that crisis. As highlighted at the outset, Spain was considered the outstanding student in the European classroom as a consequence of its astonishing growth path between 1995-2007. We have seen though that all that glittered was not gold, and the growth model suffered from several inherent and inter-related problems that were for too long ignored. In the context of imbalances inside the European Union – whereby certain countries lend too much to countries that borrow too much – Spain was clearly a debt-led economy. Unable to produce the required resources to finance its growth model, Spain had to rely on debt, which was borrowed by its private sector cheaply – as a consequence of the low interest rates that accompanied euro membership – and invested in construction and real estate sectors at the expense of other sectors of the economy. This indebtedness was at the heart of the crisis.

The government and public sector facilitated the emergence of such a model through its support and protection of increasingly interwoven finance and construction sectors. Such a model enjoyed popular support to the extent that the wealth effects of a housing bubble could compensate for stagnant wage growth. Following the crisis, the government came to the aid of its finance sector (supported by the EU) and unleashed a series of socially and economically damaging austerity programmes that were well attuned to the broader EU response.

[9] This is in stark contrast with some recent pieces in financial newspapers: see, for instance, *Financial Times*, 6 April 2017, "Spain: Boom to bust and back again".

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