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Boom-to-bust: Reconstructing the Spanish economy

Part One: Into recession

ABSTRACT

In 2008, a decade of strong and sustained growth in Spain came to an end as the economy fell into recession. This article charts the passage of the economy into recession and examines conditions in the financial system, property market and labour market that were peculiar to Spain. Half the financial system was subject to considerable political interference, a property market bubble was allowed to develop and the labour market had developed a dual character in which one segment remained very rigid. These factors contributed to a protracted recession, accompanied by rapidly increasing sovereign debt and exceptionally high unemployment.

KEYWORDS: financial system, labour market, property market, public debt, recession, Spanish economy

INTRODUCTION

In 2008, a decade of strong and sustained growth in Spain came to an abrupt end. Along with many others around the world, the Spanish economy first slowed then contracted following the shock of a financial crisis at the heart of the global financial system and its subsequent global repercussions. As in many other countries, growth was built on the foundations of institutional reform characterized by progressive liberalization and integration into the global economy. Structurally, growth was accompanied by a substantial increase in the labour force, further restructuring within manufacturing industry, a continued shift of labour into services and especially a cyclical expansion of employment in the construction and property sectors.

The 'liberalization' model allowed an economy to develop that was excessively dependent on a nexus of activities centred on construction and property and on domestic household consumption accompanied by low savings (the ratio of savings to gross disposable income falling to 10% in the first quarter of 2008; INE 2008) and high levels of private sector debt (household debt rose to over 130% of gross disposable income in the last quarter of 2007; Banco de España 2009). Simultaneously, strong consumer demand sucked in imports, resulting in a large current account deficit (some 10% of GDP in 2007). This unbalanced economy also displayed other weaknesses. These included low levels of productivity, weak indicators related to the knowledge economy, a high degree of dependence on imported energy and a dual labour market in which one-third of the labour force had little or no protection, whereas the other two thirds were protected by measures that made it expensive for companies to adjust to changing market conditions.

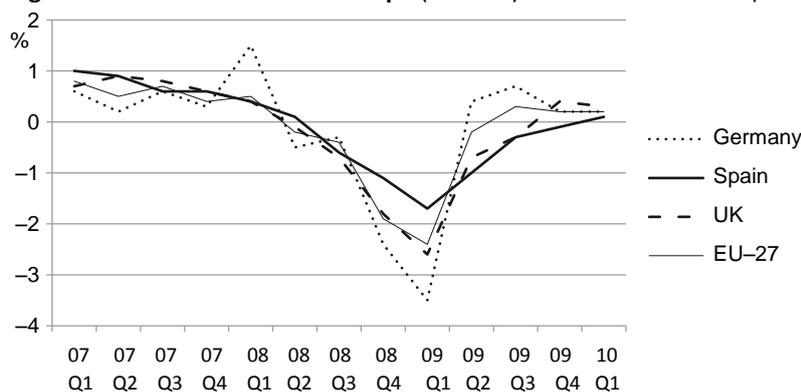
Weaknesses in the economy were exposed by the economic shock waves spilling out from the financial crisis, leading to calls for a new model of development (echoed by the Spanish Foreign Minister, Miguel Moratinos, in making the construction of such a model in Europe a goal for the Spanish presidency of the European Union (EU) in 2010; Cinco Días 2009). But what would this new model look like and would it mark a paradigm shift from the model that emerged in the late twentieth century? Any new model would have to be constructed within a complex domestic political environment, within the framework of international agreements, probably within the single European currency area, in the context of increasing competition and new market opportunities presented by the growth of emerging economies, and against the background of increasing pressure on raw materials and the risks of climate change. In addition, overhanging any economic recovery

was an unbalanced world economy (big differences in national savings, consumption and investment rates reflected in large trade deficits and surpluses) and difficult decisions over the nature and timing of any exit strategy by the government from substantial discretionary spending on economic stimulation packages. The discussion is covered in two linked articles. Part one charts the passage of the Spanish economy into recession. It then examines three key features of this passage that were specific to Spain, the financial system, conditions in the property market, and the exceptional level of unemployment. The second article considers the policy response of government, weighing-up long-term proposals to remodel the economy. It concludes by drawing together some of the threads of the discussion in the two articles.

THE PASSAGE INTO RECESSION

Following the economic crisis of the early 1990s, growth accelerated in the late 1990s and into the new century to levels that outpaced most other economies in the European Union. In the first quarter of 2007, quarterly growth measured on an annual basis was around 4%. From there it fell slightly in the second quarter and then more noticeably in the second half of the year. The slowdown became more pronounced in the first three-quarters of 2008, with a severe deterioration in the final quarter of 2008 and first quarter of 2009 (Figure 1). By the second half of 2008 the economy was in recession where it remained until just returning to growth in the first quarter of 2010.

Figure 1: Evolution of GDP in Europe (Quarterly GDP rates on an inter-quarterly basis)



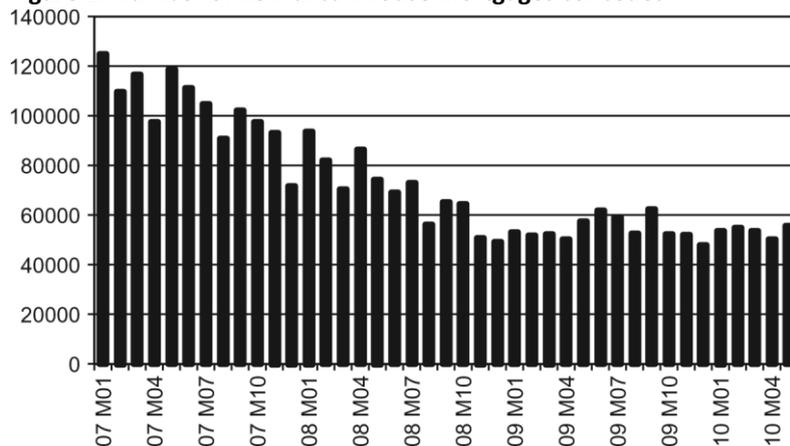
Source: Eurostat 2008, 2009a and 2010a.

Although severe, contraction in the value of output was less acute than the average in the EU-27 and for many other EU economies such as Germany and the United Kingdom (Figure 1). However, by the second quarter of 2009 EU economies generally were staging a slow recovery, whereas that of Spain looked set for a longer slump despite a substantial government stimulus package. In addition, the rate of unemployment rose to an exceptionally high level. As in the early 1990s, Spain was slightly behind the curve of contraction, but heading for a more protracted slowdown with especially grave unemployment and debt problems.

The initial impact of the credit crisis was felt in the financial sector, where closure of the wholesale money markets from summer 2007 left banks with no alternative but to reduce lending. The financial crisis quickly spread to the property market, which had in fact begun to slow from the beginning of 2007. On an annualized basis in February 2007, the number of new house mortgages conceded was down nearly 4%; by May 2007, it was down 6% and by October down 12% (Figure 2). The pace of decline accelerated through 2008 with some 29% fewer house mortgages being conceded in May 2008 than in May 2006, and 42% fewer in October 2008. In January 2009, the number of house mortgages conceded had fallen by 58% from its equivalent figure in January 2007. It then stabilized at this lower level of demand through to mid-2010.

Credit restrictions and growing concern over employment prospects also translated into a broader contraction in consumer demand, especially for durable goods – notably household furnishings and cars. Thus, in the saloon car market the number of registrations did not fall noticeably in the second half of 2007 but were almost consistently lower on a monthly basis in 2008 compared with those in 2007. In the first half of 2009, car registrations were down by half on the same period in 2007. A new package of incentives (Plan 2000E) then lifted registrations through to mid-2010 when the incentives ended (Anfac 2010). Across Europe similar incentive schemes contributed to the maintenance of car production in Spain through 2008 and 2009 but commercial/industrial vehicle production fell such that all motor-vehicle production dropped by one-quarter from 2007 to 2009 (Anfac 2010).

Figure 2: Number of new urban house mortgages conceded



Source: INE 2010a Estadística de Hipotecas.

With the tight conditions in credit markets continuing and the property and durable goods markets in rapid decline, what had been a crisis in the financial markets transformed into a wider economic crisis. This was exacerbated by similar downturns in the economic cycle around the world, reducing world trade especially in the two main markets for Spain, the European Union and the United States. As in the housing market, signs of a downturn in the economic cycle were detectable in the industrial sector by early 2007, turning into a contraction in industrial output by late autumn. The contraction intensified in the spring of 2008 and then became very severe in autumn 2008 through to the summer of 2009. During the months October 2008 to October 2009 the decline in industrial output was running at double digit levels (INE 2010b) before moving back into positive territory in March 2010. Neither was the service sector immune. By May 2008 the index of business in the service sector had turned negative on an annualized basis and from late autumn it too was recording double digit declines. With economic activity lower across the economy, energy demand also fell redefining the debate over future energy provision (demand had been growing at around 3% in 2007, in 2008 it fell to around 1% and in 2009 contracted by over 4%; REE 2010). Finally, although sales of non-durable consumer goods held up better than durables, the contraction in consumer demand reduced retail sales leading to a fall in retail employment. By autumn 2008 the initial downturn in the economic cycle had metamorphosed into a deep and broadly based recession that lasted through 2009 with further contraction forecast for 2010.

As the economy collapsed into recession in 2008, the public finances deteriorated. Spain entered the economic downturn with healthy public accounts. There had been four years of either budget balances or budget surpluses, Spanish public debt retaining a maximum credit rating from December 2001. In addition, the ratio of public sector debt to GDP was exceptionally low at around 36% at the end of 2007. This picture provided scope for discretionary public spending in 2008 and 2009 to stimulate the economy. But as the economy contracted, tax revenues evaporated, falling more rapidly than the contraction in GDP as substantial revenues from property market transactions were

lost (contrasting with the near equal contraction of tax revenues and GDP in the early 1990s; BBVA 2009). In addition, substantial net transfers from the European Union in various aid schemes dwindled under the European Financial Perspective 2007–13. In contrast, public spending to support the economy rose sharply along with obligatory expenditure through the welfare state. By the end of 2009 the budget deficit had risen to 11.2% of GDP and public debt was set to climb above the Stability and Growth Pact (SGP) threshold of 60% (the latter, still relatively low by international standards). In January 2009 Standard & Poor's reduced Spain's sovereign debt rating by one notch. In February the European Commission issued a warning to Spain over its deficit (the first stage in the excessive deficit procedure of the SGP) that required the government to respond with a plan to cut its deficit back to the ceiling of 3% allowed under the SGP by 2013. By the autumn of 2009 there was little scope left for discretionary public spending. Both market and political pressures were building for the government to identify a strategy to contain public expenditure and reduce the public sector deficit. There would have to be cuts across the public sector, in pay, employment and investment. The broad base of recession was now a reality in the public sector.

THE FINANCIAL SYSTEM

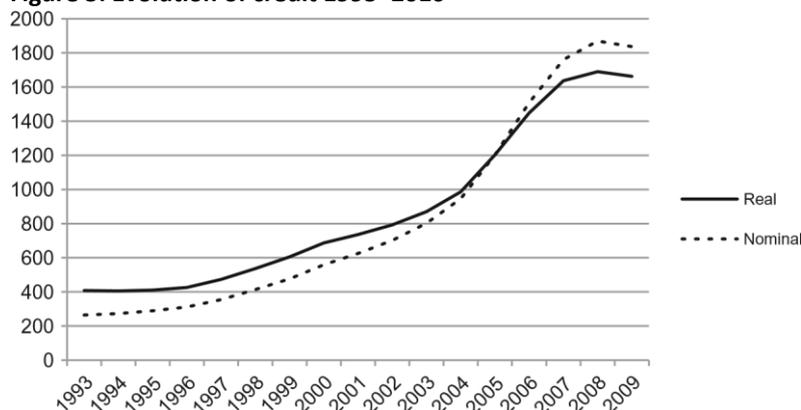
The financial system was at the heart of the problems that beset not just the Spanish economy but economies around the world. In Spain, the financial system emerged relatively unscathed from direct involvement in the critical areas of sub-prime lending and complex derivative products. This was as a result of strict bank regulation under the Bank of Spain (that in part resulted from the serious banking crises in the late 1970s/early 1980s) together with the strategy followed by the two leading Spanish commercial banks to expand their retail franchises rather than develop major investment banking activities. A policy of counter-cyclical provisioning also contributed to stronger financial institutions, which were able to acquire distressed banking assets as these were put up for sale in other countries (e.g. the deposit business of Bradford & Bingley in the United Kingdom and banking assets in the United States).

But the Spanish financial system was not isolated from the problems in global wholesale money markets. It too had substantially expanded credit, notably to the construction and property sector. Total outstanding credit advanced by credit entities grew in nominal terms from €108 billion in 1985 to €414 billion in 1998, thence more than quadrupled to €1870 billion by the end of 2008. In real terms (after allowing for inflation), credit less than doubled from €231 billion in 1985 to €437 billion in 1998, thence more than tripled to €1406 billion at the end of 2008 (Figure 3). Moreover, an increasing proportion of credit was directed towards the acquisition and refurbishment of houses. Thus in 1994 only one-quarter of credit went into the housing sector, by the end of 1999 this had reached 30%, growing to 37% at the end of 2005. As a proportion of credit going to productive activities, that in housing rose from 42% in 1994, to 54% in 1998, thence up to 74% by the end of 2005 (Banco de España 2010a). The credit system became more dependent on the housing market and a greater proportion of credit was sucked into the non-productive housing sector.

The banking sector comprised the commercial banks and the savings banks (cajas de ahorros). In 2008, there were two major commercial banks (BBVA and Santander) that accounted for close to 40% of bank deposits, six other commercial banks accounted for most of the other 10%. Mutual organizations, including 45 members of the Spanish Savings Bank Confederation (CECA) plus a number of cooperatives made up the other half of the banking system. An aggressive strategy of branch and lending expansion had been followed by the savings banks as many regionally centred ones attempted to access the national market. The number of savings bank branches rose by nearly 30% from 19,268 at the end of 2000 to 24,985 at the end of 2008 (Banco de España 2010b). In contrast, bank branches (banks registered in Spain) fell by 1% from 15,811 to 15,580 (Banco de

España 2010b). As the recession bit, the country was overbanked, the financial system fragmented and the savings banks dominated by local political elites.

Figure 3: Evolution of credit 1993–2010



Figures (in euro billions) are for all credit provided by credit entities (real terms data rebased to 2005, IMF 2010).

Source: Banco de España 2010a: Boletín Estadístico

The falling value of bank assets (notably property prices but also equity holdings) and growing levels of bad debt (rising from below 1% in 2007 to 5.5% in May 2010; Banco de España 2010a) sapped the financial strength of both the commercial and savings banks, placing some of them at risk. In early 2009, the Bank of Spain was forced to intervene to support the savings bank Caja de Ahorros de Castilla-La Mancha and then in May 2010 to take into administration the Córdoba based 'CajaSur'. The Bank first urged and then demanded a process of restructuring (mergers) to create more stable financial institutions. Strengths and weaknesses in the banking system were made transparent in July 2010 following stress testing by the Committee of European Banking Supervisors (CEBS). Five of seven banking groups in the European Union that did not meet the stress criteria were Spanish savings bank groups (stress tests by other institutions pointed to more Spanish banks requiring additional capital). But the Spanish banks had been more open than those in some other countries and the soundest bank in the European Union according to the stress criteria was also Spanish.

Restructuring was slowed by political considerations, with regional governments promoting intra-regional mergers rather than inter-regional ones as a means of retaining regional political influence over regional finance. The situation underlined the tensions inherent in the emerging form of the state – that is between a unified state and regional independence (see Balfour and Quiroga 2007 for a discussion of these issues). In addition, what appeared to be a very solid part of the economy at the outset of the crisis was shown to have serious underlying weaknesses. By July 2010, a combination of political and market pressures had transformed the savings bank sector, to one with a much smaller number of merged savings bank groups operating under a new regulatory structure. This structure allowed private capital with voting rights into savings banks changing their mutual status and considerably reduced political representation on their governing committees (Ley de Organos Rectores de Cajas de Ahorros, BOE 2010).

THE PROPERTY MARKET

What distinguished the bust in Spain most from that in other countries was the growth of a property price bubble and its subsequent collapse to leave an enormous overhang of unsold residential property. Spain was especially vulnerable to this highly cyclical sector because a feature of the economy was the relatively large proportion of the labour force employed in construction. At its recent peak in early 2007, the narrowly defined construction sector contributed some 11% of GDP compared with 6.5% in 1997 (INE 2009a) and employed 13% of the employed population compared with 10% in 1997 (INE 2010c).

From the mid-1990s money was sucked into the property market by high returns and expectations of continued high returns. Markets were operating to allocate resources to their most profitable but not their most productive use. This failure of the market mechanism along with other examples of such failures (as in the pricing of risk in financial assets) undermined the previously unstoppable liberal argument for unfettered markets. It also contributed to continued low productivity despite high levels of investment. Impressive new property developments and infrastructure masked static productivity. Manufacturing industry as elsewhere in the industrialized world was being reshaped by competition from emerging economies both in Europe and further afield. This was the 'postmodern' Spanish economy, dominated by services, many of them in the non-traded sector (e.g. employment in the public administrations¹ rose from 2.28 million in January 2000 to 2.64 million in January 2009; MPT 2009). Hence, whenever the economy expanded, merchandise trade quickly slipped into deficit. Prior to the collapse of the housing market, numerous institutions had issued warnings. For example, in 2002 the Bank of Spain warned that house prices were above justifiable levels; in October 2003, it estimated that houses were 30% overvalued. In June 2005, it estimated that houses were 24–35% overvalued. In the same year, similar warnings were issued by the OECD, the Bank for International Settlements and The Economist magazine. But these warnings went unheeded as risks were ignored in the face of huge profits.

A number of factors contributed to the rise in property prices, which was one of the strongest in Europe and on par with Ireland and the United Kingdom (for a quantitative model of house prices, see Garriga 2010). Prices rose on the back of falling real interest rates (itself partly attributable to a savings glut in emerging economies) and easy credit (as banks sought to increase their profits using plentiful low-cost funding in global wholesale money markets while accepting more risky loans guaranteed against rising property prices). These conditions were in place across many markets. Hence the question arises as to why in some markets price bubbles appeared. In Spain, the answer to this question lay in the convergence of beneficial interests among all the key actors in the property market: the construction industry, developers, financiers, local authorities and property buyers, while the European Central Bank focused on targeting inflation.

On the demand side several factors were at play. A wave of immigration from the end of the 1990s largely accounted for a rise in the population from 40 million in 2000 to close to 47 million in mid-2009. Long-term social change was also leading to smaller household sizes in a country where home ownership rates were among the highest in Europe (underpinned by mortgage tax relief and lack of an adequate private rental sector, which itself was the product of a history of controlled rents). In addition, second home ownership was common and demand for second homes rising from both nationals (partly to compensate for high density apartment living in cities) and foreigners who looked for homes especially around the Mediterranean coast. Demand was further fuelled by an investment motive driven by expectations of higher prices while real savings rates fell to low levels. There were opportunities to profit by buying off-plan and selling on completion. For the final resident of the property, there was mortgage tax relief and the prospect of a tax-free capital gain.

¹ Included in employment in the public administrations are those working for the central administration – central government, state agencies, police and security forces, armed forces, judiciary and public companies, regional government, local government and the universities.

On the supply side, property development became an increasingly profitable value chain for both property developers and local authorities. For property developers, land not zoned for housing could be acquired more cheaply than an application made for housing development (a process that became easier after the reform of the Land Act in 1998). Even the process of making an application pushed up the land value and allowed the owner to sell the land on at a substantial profit. If the application was successful then the land value rocketed, bringing windfall profits to the land owner, revenue for the local authority (in land development tax) and opportunities for personal benefit to individuals involved in the planning approval process. Financing development was facilitated by cheap and readily available credit from the banks, which sometimes also had equity stakes in the construction and property development companies. In addition, increased selling of property off-plan reduced financial uncertainties and brought more rapid repayment of development costs. Unskilled, relatively low-cost labour was available in the reservoir of unemployed (which never fell below 8% of the working population) and the wave of immigrant labour. Employment in the construction sector rose from 1.2 million in 1996 (9.2% of the labour force) to 2.7 million (13.3% of the labour force) in the second quarter of 2007 (INE 2010c). At that time, there were almost as many people employed in construction alone (excluding related activities) as there were in the whole of the industrial sector. Labour costs were also held down by the widespread use of fixed-term contracts and labour in the black economy.

Land prices were driven up by speculation in land and the practice by construction companies of amassing land banks. These were attractive because simply acquiring land pushed prices up, land prices were rising and holding land was relatively inexpensive due to low finance costs. The title of Francisco Jurdao Arrones's (1979) book *España en Venta* [Spain for Sale] had touched a theme that continued to reverberate down the decades.

Apart from developers, builders and all the businesses supplying the construction industry, the financial sector benefited from the multitude of financial transactions associated with the development process. With property prices rising, loans looked secure as in the case of default the properties could always be sold for more than the value of the loan. Fortunately, relatively tight regulation of the banking sector meant that significant numbers of sub-prime loans were never advanced. Nevertheless, loan books were increasingly dependent on the property sector.

One final element contributed to the mix on the property development side that resulted in serious oversupply; this was the fragmented structure of the residential building industry. Although there were some very large residential development companies (many backed by the major construction firms and the banks), there were a multitude of small developers too. In the construction industry, 86% of companies on 1 January 2009 employed five or less salaried people (INE 2009b).

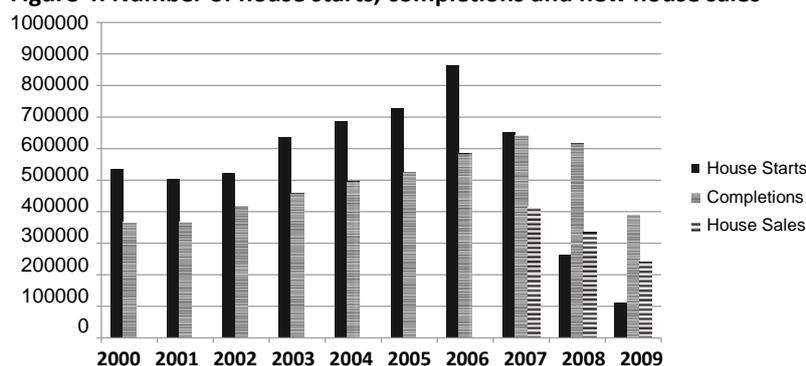
Apart from the property developers the other agents in the property development process were the local authorities, which were responsible for the urban planning system. These too stood to gain substantial financial benefits from promoting construction work. Under Article 142 of the Constitution, local authorities were financed by transfers from the state and their respective regional governments and by their own taxes and charges for supplying local services. Although the largest slice of income was from state and regional transfers, these sources were strictly controlled, as too was additional borrowing through the financial markets. Equally, charges for local services and some taxes tended to be held down for political reasons. This left income from taxes on property and property development as one of the few areas where income could be increased. Despite a string of reforms to local finance, property income continued to be a crucial source of local authority finance. Thus in 2005, approaching 50% of local authority income, excluding that from transfers or raised through the money markets, came from various property related income streams.

The largest source was the Property Tax (Impuesto sobre Bienes Inmuebles, IBI), followed by the Tax on Buildings and Building Works (Impuesto sobre Construcciones, Instalaciones y Obras, ICIO) and then by the Tax on Increased Urban Land Values (Impuesto de Incremento de Valor de Terrenos Naturaleza Urbana, IIVTNU; often referred to as the impuesto sobre la plusvalía). In addition, developers had an obligation to cede a proportion of their development sites to the local authority and to make some local improvements. Add in other income from property transactions, then approaching 50% of income arose from the property sector. With such large sums of money riding on development approvals, corruption was endemic in local authorities, with many high-profile cases such as that in Marbella or more recently that in Alcaucín (province of Malaga, El País 2009).

Successive land laws attempted to address the land supply issue and reduce house prices, but the changes made under the 1998 Land Law (Ley del Suelo) simply exacerbated the problem. Under this law all land that was not specifically protected could be built on (if a license for change of use was granted). If the local authority did not grant licences, then they could not pay for the services they were providing. Hence under a law that was designed to increase the supply of land and make housing cheaper, land prices rose dramatically (by 500% 1998–2007) and with them house prices (by well over 150% on average).

Thus, the property price bubble arose from a combination of social change, conditions in financial markets, the nature of the labour market, the tax system, planning regulation and local authority financing arrangements. As the bubble inflated, it was ignored by many developers and their financiers. To paraphrase a former chief executive of Citibank (quoted by Roubini 2009), while the music played, developers continued to stand up and dance (although the larger construction companies diversified their activities). The substantial oversupply and legacy of unsold housing was the result of the behavioural response of the actors in the property market coupled with the nature of the property development cycle. The music continued to play until mid-2007. When it stopped, the nature of the property development cycle meant that developments already begun would take several years to complete. Thus, many developments initiated in 2006 and early 2007 were only due for completion in 2009 and 2010. This is illustrated in Figure 4, which shows the pattern of house starts, completions and sales.

Figure 4: Number of house starts, completions and new house sales



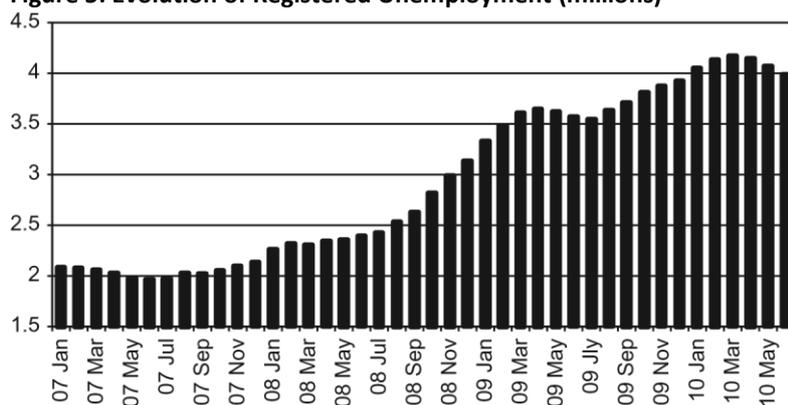
Source: Housing Starts and Completions Ministerio de Fomento 2009. House Sales (new houses): Ministerio de Vivienda 2010

UNEMPLOYMENT

Apart from the exceptional conditions in the housing market, the other exceptional feature of the economic crisis in Spain was the extraordinary rise in unemployment (Figure 5). From the late 1990s the labour force began to grow on the back of the largest wave of net international migration in the European Union (Eurostat 2009b), which resulted in the resident population rising from some 40.5 million at the beginning of 2000 to 46.9 million at the beginning of 2010 (at 16% the largest national

rate of increase in the EU-27; INE 2010d). On 1 January 2010 the immigrant population was officially estimated at 5.7 million, 12% of the population (Eurostat 2009b). The labour force (economically active) rose by 30% between the first quarter of 2000 and the first quarter of 2010 inclusive (INE 2010c), reflecting the working age structure of a large proportion of the immigrants. Despite this rise, in July and August 2003 the absolute number registered as unemployed fell to just over 1.5 million and remained close to 2 million until the end of 2007. From that point unemployment increased steadily until mid-year and then more sharply through the autumn and into spring 2009, by which time it had risen to 3.6 million (April unemployment rate of over 18%; 2009). By early 2010, registered unemployment topped 4 million, a rate of some 20% and a level not seen since the early 1990s. According to Eurostat (2010b), the seasonally adjusted rate in May 2010 of 19.9% was by far the highest in the EU-27, double the EU-27 average of 9.6% and the eurozone average of 10%. Much of the rise in unemployment was attributable to contraction in the property and construction sector, where it was estimated that for every house not built two to three jobs would be lost. But substantial losses were also recorded across the economy. Thus, according to government figures on registered unemployment (MTyI 2010), between January 2008 and March 2010 the number of unemployed rose by 85% (from 2.26 million to 4.17 million). On a sector basis, it rose by 60% in agriculture (from 75,361 to 121,700), by 82% in industry (from 289,695 to 525,900), by 172% in construction (from 292,797 to 797,600) and by 74% in services (from 1,382,354 to 2,398,700) (MTyI 2010).

Figure 5: Evolution of Registered Unemployment (millions)



Source: Ministerio de Trabajo y Inmigración 2010

Unemployment was especially acute among young people, the less well educated, the foreign population and in the south of Spain. Against a national average unemployment rate around 20%, the seasonally adjusted rate in May 2010 for youth unemployment (those aged under 25) was an alarming 40.5%, double the EU-27 average of 20.5% and the eurozone average of 19.9% (Eurostat 2010b). In terms of education level, in the first quarter of 2010, 22.6% were classified as illiterate or with only primary school education and 18.4% had post-secondary school education (MTyI 2010). The growth of unemployment was also especially intense among the foreign population, where the unemployment rate was 35% against that among the Spanish population of 20% (MTyI 2010). In addition, the long-term unemployed (those unemployed for more than 1 year) rose from 433,500 in the second quarter of 2007 to 1,787,400 in the first quarter of 2010, up 404% (MTyI 2010). Finally, the north–south divide in unemployment remained, with rates below 17% in Aragón, Asturias, Cantabria, Castilla y León, Galicia, Madrid, Navarra, País Vasco (the lowest at 10.9%) and La Rioja (17.9 in Cataluña), but over 21% in Andalucía (27%), Baleares, Canarias (the highest at 28%), C.Valenciana, Castilla-La Mancha, Extremadura and Murcia (MTyI 2010).

The explanation for the rapid rise in unemployment lay in a combination of a rise in the number participating in the labour market (including immigrants and the increased female occupation rate –

up from 32.5% of the female population aged 16–64 in 1995, to 42% in 2000, 52% in 2005 and 53% in the first quarter of 2010; MTyI 2010), continued structural decline in employment in agriculture and industry and the cyclical slowdown in the economy (especially in construction). But part of the increase must also be attributed to the institutional structure of the labour market, with a third of those employed on fixed-term contracts. Despite government incentives to increase the number of open-ended contracts (including the labour market reforms of 2006), these actually decreased during 2008 and 2009. According to the MTyI (2009) in 2008, only 11.5% of all new contracts were open-ended, in the first four months of 2010 this had fallen to 9.3% (MTyI 2009).

CONCLUSION

From an economy characterized by exceptional out-performance in the first decade of the twenty-first century and a realistic claim to be at the heart of Europe, Spain entered the second decade categorized as a European peripheral economy with low productivity, a substantial debt problem, stressed financial system, bombed-out domestic residential construction industry, staggeringly high unemployment and facing a debt-deflation spiral of decline. Even continued membership of the euro was in question. A second article (forthcoming IJIS 23:2) – Policy responses to the economic crisis – considers the policy responses to this bleak picture.

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