The Crisis and Fiscal Policies in the Peripheral Countries of the Eurozone

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Introduction: The political context

To understand the situation in the countries at the periphery of the European Union, four countries within the Eurozone, Portugal, Ireland, Greece and Spain, we have to understand the political context they have in common. All of them were governed by fascist or fascist-like dictatorships (Spain, Portugal, and Greece) or by authoritarian right-wing regimes (Ireland) for most of the period from the late 1930s or early 1940s until the late 1970s. This history is usually ignored in analyses of these countries.

This shared history, however, has determined the nature of their states, a critical variable for understanding countries’ economic behavior. Their states have been very repressive. Even today, these countries have the largest number of policemen per 10,000 individuals in the EU-15. Another shared characteristic is their very low level of state revenues and their highly regressive fiscal policies. The revenues to the state are much lower than the EU-15 average: approximately 34%
of GNP in Spain, 37% in Greece, 39% in Portugal, and 34% in Ireland, compared with the EU-15 average of 44%, and compared with 54% in Sweden – the EU-15 country where the left has governed for the longest period. The low state revenues result from extremely regressive policies. The super-rich, rich, and high-income upper middle classes do not pay taxes at the same level and intensity as those in most of the central and northern EU-15 countries – a consequence of a history of government by ultra-right-wing parties. Of course, progress has been made since the dictatorships ended. But the dominance of conservative forces in the political and civil lives of these countries explains why their state revenues are still so low.

As a result, the public sectors in Portugal, Ireland, Greece, and Spain are extremely underdeveloped. And their welfare states are poorly funded and very limited, including their public transfers (pensions) and public services (medical care, education, childcare services, homecare services, social services, and others). Indicators of this are many. One example is public social spending as percentage of GNP, which is lower in these countries than the EU-15 average (27%): Spain, 22.1%; Greece, 25.9%; Portugal, 24.3%; and Ireland, 22.1% (compared with Sweden, 29.3%). Another example is the percentage of the adult population working in public services of the welfare state – again, lower than the EU-15 average (15%): Spain, 9%; Greece, 11%; Portugal, 7%; and Ireland, 12% (compared with Sweden, 25%). In fact, Greece’s percentage is three points higher, 14%, because it includes services for the military, (which represents approximately 30% of public employees).
The specificity of the political regimes

Thus, for these four countries, not enough attention has been paid in the economic literature to the consequences of being governed by ultra-conservative forces. The influence of such forces has been enormous. It is also important to emphasize that the conservative forces in these peripheral countries are different from those in northern and central EU-15 countries. They do not belong to democratic traditions since they are the inheritors of either fascist or authoritarian regimes. Even today, after almost 30 years of democracy, such forces continue to be very influential in the four states, even when the states are governed by social democratic parties. As just one example, Spain’s Supreme Court has taken Judge Baltasar Garzon, who used to be a member himself of the Court, to trial for daring to inquire about crimes committed by General Franco’s fascist regime. It is not fully comprehended outside Spain just how influential the ultra-right-wing forces still are within the Spanish state. They dominate political culture in many different ways, including control of the major media. There are no major left or left-of-center media in Spain, or in the other countries in this group.

The domination of the state by ultra-conservative forces has many consequences besides their low level of state revenues, their regressive fiscal policies, and their underdevelopment of the welfare state. Labor income, as percentage of national income, has declined since 1992, when policies were implemented (including by social democratic governments) in preparation for entering the Eurozone. This income decline has occurred more rapidly in Portugal, Ireland, Greece, and Spain than the EU-15 average, and is particularly accentuated
in Spain, with a decrease from 70% to 61% of national income – despite an increase in the percentage of working adult population.

As noted, a consequence of domination by conservative forces, considerably limiting the public reforms approved and implemented by social democratic governments from the early 1980s onward, is regressive fiscal policies. As a result of these policies, the impact of state interventions on income redistribution has been very limited. For example, in Spain, as late as 2009, the level of poverty (60% of median income) declined only 4 points after implementation of state interventions (public social transfers): from 24% before to 20% after transfers. The EU-15 average decreased from 25% to 16%. Sweden’s poverty rate fell from 27% to 13%. The decline in poverty rate resulting from public social transfers in Spain is the lowest in the EU-15. Another indicator of the limited redistributional impact of state interventions is that the Gini coefficients in all four countries are higher than the EU-15 average (29.2). Spain’s Gini coefficient is 31.3, the same as Ireland’s; Greece’s is 34.3; and Portugal’s is the highest at 36.8.

**How the crisis has been building up**

Another characteristic of this group of countries is the acceptance by the governing social democratic parties of most of the neoliberal policies pushed by the EU establishment. This acceptance has been generalized among the social democratic parties of the European Union. Actually, these parties were part of the consensus in developing neoliberal policies (usually referred to as the “Brussels consensus,” the European version of the “Washington consensus”). As part of this
consensus, both conservative-liberal and social democratic governing parties have been reducing taxes, particularly for the top income brackets. It was none other than Spain’s socialist candidate in the 2004 election (and later prime minister), Jose Luis Rodriguez Zapatero, who promised to reduce taxes if elected, saying that lowering taxes was a cause to be promoted by the left. The major economic thinker of Spain’s socialist party at that time was Jordi Sevilla, an economist who wrote in his book *The Future of Socialism* that “the left had to stop raising taxes and increasing public expenditures” – this said in the EU-15 country with the lowest state revenues and poorest welfare state.

The tax reductions over the past 15 years have led to a structural public deficit that was disguised by the fast economic growth created by the housing bubble, responsible for the banking–real estate–construction industry complex at the center of the bubble. When the bubble burst, and the economy came to a halt, the structural public deficit appeared in all its intensity. The public deficits in Portugal, Ireland, Greece, and Spain were the result of declining state revenues, not expanding public expenditures. This is why the public policies of these governments are profoundly wrong. They have been cutting public spending, assuming, incorrectly, that the cause of public deficits was an exaggerated growth of public expenditures.

**Arguments used to justify cuts in public expenditures**

The slogan now being used to justify these cuts is: “The country has been living beyond its means.” Major political figures in the four countries claim that their
welfare states are larger than they can pay for. But the data show otherwise. In Spain, for example, the GNP per capita is 94% of the EU-15 average, but public social expenditure per capita is only 72% of the EU-15 average. If it were 94%, the Spanish state would have 66,000 million more euros than it does today. So, Spain has the resources. The problem is that the state does not collect them, because its fiscal policies are so regressive and fiscal fraud is widespread among high-income groups and economic and financial corporations. Actually, banking in Spain is the primary entity responsible for fiscal fraud. Mr. Botin, the country’s major banker (president of Santander Bank, the third most profitable bank in the world, after two Chinese banks), was discovered this year to have 2,000 million euros in a Swiss bank account – not declared until two whistleblowers at the bank went to the press. Such fraud is general practice. The tax inspectors of Spain’s Ministry of Economy estimate there are 88,600 million euros that the state does not collect because of tax fraud.

How and why the crisis arose

Before the financial crisis there was an economic crisis, largely the result of the decline in labor income as percentage of total national income. The neoliberal policies developed since the 1980s (accentuated over the past 15 years, and carried out by governments of various political persuasions, including social democratic, in Spain, Greece, and Portugal) have had a strong impact on income distribution, accelerating the concentration of income in the high income brackets. The decline of labor-derived income diminished the purchasing power of the popular classes,
forcing them into debt in order to maintain their standard of living. And credit was relatively easy to obtain, because house values were rising and provided a means of borrowing from banks by putting up homes as security. The growth of the credit sector (and of financing) was based on the decline of labor income. But the decline of labor income was creating a major problem for demand and limited profitability in the economy.

With this limited profitability in the productive economy, the super-rich, rich, and upper-income middle class invested in sectors with higher returns, especially in real estate. The deregulation of banking (and deregulation of zoning laws) during the 1990s led to a real estate bubble, based on the complex of banking, real estate, and construction industries. In Spain, this complex was the main motor of economic growth and was supported by both central and local authorities, since local authorities were primarily funded by property taxes.

Stimulating the growth of housing construction was the influx of immigrants, with the immigrant population increasing from 4% to 10% of the population in only 10 years. Housing construction reached 10% of GNP, and this sector produced the most (but very low-paid) jobs. The Spanish “miracle” of job creation was based on large investments in a speculative sector of the economy. And it was funded with debt. This is the cause of the enormous private debt in Spain, which was facilitated by introduction of the euro – much more stable in the economy than the national currency it replaced. Introduction of the euro dramatically increased the size of the financial sector in the four peripheral Eurozone countries. When the bubble burst, the whole credit economy came to a stop.
The political origins of the public debt

In the four countries, there has been an alliance between the upper income brackets (the super-rich, rich, and upper middle class, whose taxes have been reduced in the past 15 years) and the banks, on the one hand, and the state, on the other. A fruit of this alliance was the reduction in taxes that created the structural public deficit, masked by the economic growth within the bubble.

The decline of revenues to the states (the consequence of tax cuts) forced the states to borrow from the banks, where the rich deposited the money saved due to reduced taxes. The indebtedness of the states and the need to borrow were clearly related to the reduction of taxes. When the economy came to a stop as the bubble burst, the structural public deficit became apparent. Public deficits as percentage of GNP, increased substantially in all four countries from 2007 to 2009 as a consequence. Spain went from a surplus of 1.9% of GNP in 2005 to a public deficit of 11.1% in 2009. Greece went from a deficit of 6.4% in 2007 to 15.4% in 2009, with Ireland moving from 0% to 14% in the same period. In all of them, rapid growth of the public deficit was based on the extremely regressive nature of state revenues. With most taxes based on labor income and consumption, when employment declined, unemployment grew, and consumption declined, the public deficit escalated dramatically.

Solutions that are never considered
The neoliberal response to this situation, which entails cuts in public expenditures, is making the situation worse because it reduces demand. The trade unions have accurately described neoliberalism as the ideology of banks and large employers. The major media support this doctrine, based more on faith than on evidence. At the root of the problem is class power and its realization through the state.

If Spain implemented the same fiscal policy as Sweden, the Spanish state would take in 200,000 million more euros than it now does. With those millions of euros, it could create 5 million new jobs (particularly in the underdeveloped welfare state services, such as the national health service, educational system, childcare services, and other social services). If one in every four adults worked in such services (as occurs in Sweden), instead of one in every ten adults (as occurs now in Spain), Spain would create 5 million more jobs, eliminating unemployment: 5 million is more or less the number of people currently unemployed in Spain.

A second point is that the fiscal stimulus applied by most of the governments in this group of countries in 2008 was basically tax cuts and transfers. Only a miniscule part of the stimulus went to creating jobs (through investment by local authorities). Stimulating the economy through the creation of jobs has not occurred in any of these countries. Moreover, reduction of the deficit is achieved by cutting public expenditures, not by increasing taxes. The European Federation of Trade Unions has proposed alternative ways of reducing the deficit, primarily by increasing taxes (reversing the tax reductions of the past 15 years). Class power, however, is the most potent opposition to these alternative policies. A
manufacturing worker in Spain pays taxes estimated at 74% of the taxes paid by a manufacturing worker in Sweden. The top 1% of income earners in Spain, however, pay only 20% of the taxes paid by the top 1% in Sweden. This is what explains the enormously regressive fiscal policy in the four peripheral EU-15 countries and the enormous resistance to change by their dominant classes.

The problem of the public debt is thus basically a political, not an economic or financial one. The current situation is untenable because Europe’s dominant classes and their allies, the EU leadership (“the troika”: the European Council, European Commission, and European Central Bank), are trying to reduce the power of labor using the argument of “pressure from the financial markets” – the aim being to get labor to accept the huge sacrifices that the dominant classes have wanted for many years. In Spain, for example, the socialist government is cutting public social expenditures, which, besides adversely affecting economic growth and reducing level of demand, is hurting the popular classes. The parties to the left of the governing socialists have clearly shown that for each cut in public social expenditures, the government could obtain even larger revenues by selectively increasing taxes, which would not affect taxes for the majority of the population. Moreover, they have shown that the revenues obtained with those taxes could create jobs in the underdeveloped public sector, especially in the welfare state.

Another issue is that, at this time, no major force on the left has called for exit from the euro. An explanation for this is that Europe has always been a point of reference for progressive democratic forces. In Spain, for example, under the fascist dictatorship, Europe meant liberty, democracy, and the welfare state. The
attraction of Europe is now waning, though not very rapidly. Because of this, most of the debate centers on correction of the fiscal regressiveness of the state and development of expansionary policies as a way of stimulating economic growth and job production. Sectors of the left in Spain believe this is not possible, pointing to the Mitterrand case as an example of how one country cannot follow expansionary policies. This needs to be shown as wrong, although expansionary policies at the European level would help a lot. This is unlikely to occur at this time, however, given the control of the major EU institutions by neoliberal dogma.

The indignados movement

Meanwhile, a new movement has appeared which has surprised everyone. Initially led by the young unemployed, it has attracted enormous support from the majority of the population. Its primary focus is on denouncing the absence of democracy, in Spain and elsewhere in Europe, showing how governments are making decisions not mandated by the population. This movement is going to the root of the problem: the nature of democracy and who it is that democratic institutions are representing. Of course, in Spain, the government is worried about this movement. The candidate of the governing socialist party, hoping to succeed Zapatero (the Spanish president with the least popular support during the democratic period), has called for increased taxation of the bankers and the banks to help resolve the fiscal problems of the state. This is important because the proposal is a response to the public outrage directed at banking and the wealthy. The financial and industrial bourgeoisie are seen as using the “pressure of the
financial markets” as a way of getting what they have always wanted: to weaken labor. And what is really threatening to the establishment is that all the polls show enormous sympathy for this popular movement, including among large sectors of the conservative parties. We will see what happens next.

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