Spain: Zapatero sacks finance minister

Paul Stuart
18 April 2009

Earlier this month, in response to mounting criticism over his handling of the economic crisis, Socialist Workers Party (PSOE) Prime Minister José Luis Zapatero carried out a sudden cabinet restructuring. The most significant casualty was finance minister Pedro Solbes, whom Zapatero appointed shortly after the PSOE's election victory in 2004.

Zapatero originally appointed Solbes—a former minister of finance in Felipe Gonzalez's PSOE government until 1996—to reassure big business that he was committed to continuing the ousted Popular Party government's economic agenda whilst orienting Spain more firmly towards Europe.

Solbes had been the European Union (EU) commissioner for economic affairs where he was responsible for setting up and implementing the Stability Pact, an agreement to limit budget deficits in eurozone countries that required systematic attacks on welfare budgets and wage levels. He was granted the combined government post of minister of finance and chancellor after demanding total control over economic matters.

In 2004 Spain was still experiencing something of a boom, largely as a result of massive subsidies from the EU and its ability to attract international investment from those companies seeking access to the European market along with cheap labour, subsidies and low taxation. Cheap credit had also fuelled a construction and tourist boom.

This enabled Solbes to return two periods of budget surplus, an unusual event in Europe. He became most closely associated with the idea that Spain's greater level of national financial regulation meant it could avoid the worst of the global economic crisis—an idea he shared with the rest of the cabinet. This view has been comprehensively shattered. Once again Spain is described as the new "sick man of Europe."

Over the last few weeks Solbes has publicly disagreed with Zapatero, particularly over the latter's predictions for a recovery in 2010 and attempts to stimulate the economy. Solbes stated he did not see prospects for improvement until at least 2011 and that increased spending was "unaffordable." He wanted to slash Spain's public spending to lower an expected 7 percent budget deficit this year towards the EU limit of 3 percent of gross domestic product.

Instead, Zapatero replaced Solbes with the minister for public administration, Elena Salgado, saying it was necessary to "inject vigour" into fighting the recession. "Our main objective is to take maximum advantage of the measures already taken, and take new measures if necessary," Zapatero added.

He announced a €70 billion ($93 billion) fiscal stimulus programme that includes tax cuts, government-backed financing plans for families and businesses and public works projects. Solbes' departure was followed two days later by the resignation of his right-hand man, Economy Secretary David Vegara.

Zapatero had hoped to keep the restructuring under wraps but, according to reports, party discipline broke down and details were leaked to the press which described it as a sign of "growing nerves." Zapatero stated, "Political developments and the economic situation demand a change of rhythm to confront the future with new drive and greater strength ... The fight against the economic crisis is our top priority [and] this government team has been chosen in order to overcome the crisis and forge a new economic model."

On taking office, Salgado implicitly criticised Solbes: "We will not sit quietly waiting for the economy to recover; we have to go out and seek recovery, we have to fight for it." She added, "We will make all the necessary efforts to return to the path of growth as soon as possible." The assumption that underlies Zapatero's economic strategy is that the crisis will bottom out towards the end of this year and the country will return to the record growth rates of the last decade.

Zapatero's cabinet reshuffle came in the wake of the crash last month of regional savings bank Caja Castilla la Mancha and its subsequent bail-out. This led to a series of gloomy reports contradicting Zapatero's economic predictions. The *Economist* said, "Spain may have just undertaken the first bail-out of the second act of the banking crisis."

The magazine, quoting Santiago López Díaz, an analyst at Credit Suisse, continued, "They are deteriorating fast. The Bank of Spain contends that the problem is manageable, but a large bail-out looks inevitable and will be complicated by the politicised governance of the *cajas* [savings banks]. The episode is a reminder that banks' woes have moved on from mark-to-market losses on esoteric trading assets to big hits on traditional loan books."

The cause of growing tensions in the cabinet is the sheer speed with which events are developing. On April 3, chief economist at the savings bank Caixa Catalunya, Xavier Segura, warned, "This recession is much more severe than any of us originally believed. It is so intense that our predictions cannot keep pace." He pointed to an estimated 24.3 percent decline in investment in capital goods this year, stating, "This is really worrying ... The investments made today are the jobs of tomorrow."

On the same day, the Purchasing Managers' Index published by Markit Economics reported a decline in Spanish business activity that "marked the fifteenth consecutive month of contractions as companies dealt with continuing falls in new orders by cutting jobs." The increase in unemployment was the second sharpest in the history of the survey and the jobless rate is expected to reach 20 percent next year.

Later, Bank of Spain governor Miguel Ángel Fernández Ordóñez added, "The Spanish economy is immersed in a period of deep contraction, where the unemployment rate, unless measures are taken, will rise to a very worrying level."

"The Spanish economy has undergone a very severe adjustment in the past year and the economic situation in 2009 and 2010 looks complicated, set against a deep recession.

Ordóñez warned that there was "little room for manoeuvre that exists to continue using deficit spending to spur consumption."

Similarly, *Business Week* cited director of the economics department at ESADE business school, Fernando Ballabriga, "The crisis is getting worse and worse. ... If things don't pick up in three or four months, companies will run out of money. People are now in a panic," he said.

On April 13, the accounting corporation PriceWaterhouseCoopers issued a report revealing the unprecedented scale of company and individual filing of bankruptcies in Spain "as firms exhaust cash reserves and demand and credit remain scarce." The number of bankruptcies in the first three month of this year was greater than in the whole of 2007 and would "smash" a record 2,864 in 2008 to reach to over 4,000 this year. The majority are in areas previously identified as engines of growth.

This week the Deputy Prime Minister, Maria Teresa Fernández de la Vega, caused consternation in government circles when she said that "Nobody knows when or how we will get out of the crisis."

International financial observers expressed disquiet over Solbes's sacking. They considered him the only stable presence in Zapatero's cabinet and worry that his departure augurs a period of deepening political turmoil. Solbes had tried to remove labour protection laws that prevent mass firings of full-time workers, but failed. The trade union federations warned him that a frontal assault on job protection would only lead to mass revolt.

Zapatero still views as critical the maintenance of the PSOE alliance with trade unions. "Thanks to our efforts to keep an open dialogue [with unions and businesses], until now the crisis hasn't meant any escalation in worker or social conflict," he said.

The first act of Salgado, the new finance minister, was to resuscitate talks between the union federations and the employers.