Spain: government imposes austerity and pay cuts

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The ruling Socialist Workers Party of Spain (PSOE), led by Prime Minister José Zapatero, at the end of May forced through parliament a package of cuts adding up to €15 billion. These measures are part of its commitment to slash the Spanish budget deficit, the third largest in the euro zone, from 11.3 percent to 3 percent by 2013.

Parliament also narrowly agreed to impose a 5 percent pay cut on government workers—the first such cut in wages since the collapse of the Franco dictatorship 35 years ago.

By June 16, the government is to present a draft bill for "labour reform". Piloted as phasing out the "inefficient two-tier system" of permanent and temporary job contracts, one of its main proposals is thought to include cutting severance pay from its current 45 days to 33 days for every year.

Even so, the PSOE's measures are not enough to satisfy the international financial institutions. Just the day after parliament agreed the pay cut, the Fitch credit rating agency downgraded Spain from AAA to AA+. This followed Standard and Poor's January 2009 AA+ on debt issued by Spain and its April 28 decision to reduce it further to AA.

Fitch downgraded a number of Spanish banks Banco Sabadell, Banco de Valencia and Bancaja. Also downgraded to AA+ was the Spanish government's guaranteed restructuring fund (FROB).

Its decision came in the wake of the Bank of Spain being forced to seize control of CajaSur, a savings bank run by the Catholic Church. In 2009, the bank lost €596 million and had an estimated €2.2 billion in outstanding bad loans. According to Marc Chandler, global head of currency strategy at Brown Brothers Harriman, "Spain is coming increasingly into the cross hairs due to negative developments in its banking system, and the lines of contagion from Greece are growing."

Fitch's report stated, "The economic adjustment process will be more difficult and prolonged than for other economies with AAA rated sovereign governments, which is why the agency has downgraded Spain's rating to AA+."

Fitch has demanded the PSOE enforce even more dramatic attacks on the social gains of the working class. It warned that "the inflexibility of the labour market and the restructuring of regional and local savings banks will... hinder the pace of adjustment, especially in the aftermath of the real estate boom."

The head of the International Monetary Fund, Dominic Kahn also stressed, "The issue now is to see how the measures will be implemented, especially those concerning the labour market."

Along with the European Union, the Obama administration has been actively promoting the imposition of austerity, no matter what the cost, including cuts to all welfare payments particularly unemployment benefits.

Financial observers have drawn attention to the common agreement established in Portugal on austerity and the inability to arrive at something similar in Spain.

The PSOE has been in protracted negotiations with the trade union federations--the Stalinist-influenced CCOO and the PSOE-aligned UGT—and employers' organisations to arrive at an agreement to remove social protection for workers, making it easier for bosses to engage in a further round of mass sackings. This has been the main demand of the ruling elite since the PSOE came to power in 2004 and has become a clamour since the outbreak of the world economic crisis in 2008.

The tortured nature of the negotiations stems not from any fundamental disagreements between the unions, employers and the government on the content of the labour "reforms" but on how to implement them without provoking a social eruption.

The PSOE came to power in 2004 on the back of a militant movement against the Iraq war and the Popular Party's (PP) free market economic policies. The trade union bureaucracy is concerned that it cannot control the working class if such measures are implemented all at once.

For weeks, the trade unions have threatened a general strike in opposition to the PSOE's cuts while doing nothing to mobilise against them. By setting a date for the draft labour bill, Zapatero is insisting that the trade unions must step up to the mark. conomy Minister Elena Salgado stated, "The period to reach a pact on the labour market reform is coming to an end and if these talks do not produce the desired results, the government will still begin these reforms ... before the end of June."

Jordi Sevilla, one of Zapatero's former ministers stated, "The government made a real mistake in being late in recognizing this crisis and continues to make a mistake in the drip-by-drip measures to solve it... You can only get credibility by presenting one strong and coherent package."

Raphael Gallardo, who helps manage 500 billion euros ($615 billion) as chief economist at Axa Investment Managers in Paris, praised the government's change of approach:

"The Spanish government had been in denial from 2008 to early 2010 about the magnitude of the crisis so now you have consequences... Now with the acceleration of austerity measures, like the shocking cut to civil servant wages, they finally got real and measured the severity of the crisis."

The PSOE knows this will provoke a massive backlash. The Economist commented earlier that "As he set out cuts in civil-service pay, social programmes and pensions, Mr Zapatero had the look of a man who has seen the writing on the wall."

Protests against the pay cuts and the PSOE's austerity measures began last week. Strikes are due to begin amongst civil servants next week. But the ruling elite are counting on the collusion of the trade unions to wear down opposition and help enforce the measures.

Without the Catalan party, the CiU's abstention, Zapatero's proposals could have been lost—raising the prospect of a motion of no confidence in the government and new elections.

Commentators, however, have forecast that the CiU and the PP opposition are reluctant to destablise the PSOE at this point—not least because they have no disagreement with the need for austerity measures.

Luis Arenzana, managing partner of Shelter Island Capital Management in Madrid, commented that "early elections may very well dampen the momentum for reform because a Socialist government has at least a better chance of getting union support for changing labor market rules than a center-right government would."