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**BUILDING A SOCIALDEMOCRATIC STRATEGY IN SOUTHERN EUROPE:  
ECONOMIC POLICY UNDER THE GONZALEZ GOVERNMENT (1982-93)**

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**Abstract**

By examining the overall economic and electoral strategy developed by the Spanish socialist government from 1982 to 1993, this paper evaluates the possibilities and limits of socialdemocratic policies in Southern European countries

in particular, and in non-coordinated market economies after the stagflation crisis in general.

The paper reveals, in the first place, that although the González government dismissed countercyclical demand management policies in favor of rather rigorous disinflationary goals, it still chose to develop a long-term strategy to shape the stock of Spanish physical and human capital and hence to increase the economy's productivity and competitiveness, based on massive public spending in infrastructures, education and vocational training,

The paper uncovers, in the second place, two fundamental barriers to the PSOE's economic strategy. On the one hand, it shows how the organization of the Spanish economy -characterized by semi-centralized labor markets and collective bargaining processes- made the government's disinflationary strategy rather costly to achieve. On the other hand, it reveals how strong social demands in favor of increasing public transfers compromised, from the late eighties on, the intense public capital formation strategy outlined by the González cabinet.

The paper examines, finally, the impact of the socialist government's policies on the PSOE's supporting electoral coalition. Although the Spanish socialist party was able to keep the traditional support of blue-collar workers (in both the manufacturing and the agricultural sectors), the expansion of the welfare state and the active role of the state in public capital formation policies strengthened its support in the most underdeveloped areas, among the less favored sectors (such as those with low levels of education) and among the most dependent on public transfers (the unemployed and the retired). On the contrary, the PSOE lost votes among centrist voters and white-collar salaried segments, and in urban areas.

The paper concludes by assessing to what extent it is possible to develop and perpetuate the socialist political and economic project and its supporting electoral coalition in Spain.

## **INTRODUCTION.\* SOCIALDEMOCRACY IN A NEW INSTITUTIONAL AND INTERNATIONAL CONTEXT.**

After World War II, most European socialist parties championed extensive public policies to achieve full employment and equalize social conditions without now questioning private ownership and the workings of the market. Shedding previous revolutionary programs that had insisted on the socialization of the instruments of production, socialists embraced instead a broadly understood Keynesian paradigm of economic management. Here, as Keynes himself stressed, it was "not the ownership of the instruments of production [that was] important for the state to assume. [Instead] if the state [was] able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic reward to those who own them, it [would] have accomplished all that [was] necessary."<sup>1</sup>

The postwar socialdemocratic strategy to govern the economy implied, in the first place, counter-cyclical demand-management policies. Following Keynesian ideas, unemployment was attributed to insufficient demand. Fiscal and monetary expansionary policies were accordingly used to propel consumption and hence bring the economy to its full capacity level. Demand-management policies had the virtue of reconciling the general need for growth and economic efficiency with the genuine socialdemocratic goal of redistribution. On the one hand, the use of expansionary policies could be casted as a solution that both enhanced the welfare of all social groups and maximized the efficient use of total resources of the economy. Yet, on the other hand, their implementation benefited the

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<sup>1</sup> Quoted in Przeworski and Wallerstein (1986).

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socialdemocratic electorate in particular, by promising a reduction in joblessness rates and higher incomes for the least well-off.

Going well beyond demand-management techniques, however, socialdemocratic economic policies included, in the second place, particular strategies aimed at fashioning the size and nature of the factor inputs - this is, the stock of capital and the supply of labor - in order to sustain long-term economic growth. Tax policies were geared to spur productive investments. Public businesses were nationalized and consequently employed to strengthen the nation's competitive advantage in the world market. Swedish socialdemocrats in particular engaged in aggressive human capital formation policies to turn low-wage earners into highly skilled workers. Like demand-led policies, supply-side strategies were deemed to be both efficient and fair. Socialdemocrat policy-makers expected that this strategy would increase the productivity of workers (particularly of those initially less endowed), productive sectors and regions. A public investment strategy was hence characterized by an effort to increase the overall efficiency of the economy and its competitiveness. A more productive workforce was then expected to earn higher wages. With higher wages going to the relatively least skilled sectors, pay differentials would fall and the equality of economic conditions would be 'naturally' increased. Moreover, a more productive workforce and fixed capital should raise the amount of national resources that could be employed to finance welfare policies and transfer programs without penalizing profits and therefore driving investment away.

Finally, the socialdemocratic project included, in its broadest sense, a public commitment to equalize conditions through a full-fledged welfare state.

In addition, the socialdemocratic economic program comprised an electoral strategy. Socialdemocratic parties calculated that both full employment and a socially determined minimum income (mostly through labor market regulations and welfare transfers) would lead to a progressively classless society where

individuals would be truly free, that is, unhampered by the commodification imposed on workers by the market process. In fact, such a polity would help to "manufacture broad class (even cross-class) solidarity and social democratic consensus," for in establishing the principle of universal solidarity and marginalizing the market as the principal instrument of distribution, "the entire population must become wedded to the fate of the social citizenship state and must have an incentive to promote its cause actively." (Esping-Andersen 1985: 245) Accordingly, it would be possible for socialdemocrats to forge a broad cross-class alliance which, in embracing the traditional working class and some segments of the middle class, would secure their political hegemony over time.

For several decades, the socialdemocratic project came closest to its realization in Northern European countries.<sup>2</sup> It was only in the early eighties that strong socialist majorities were elected in several Southern European countries. Here the institutional and economic conditions under which socialdemocratic programs were to be developed were partly different. Due to the decentralized nature of collective bargaining and the weaknesses of unions in Southern Europe, socialist cabinets could hardly rely on the labor movement to sustain non-inflationary counter-cyclical policies. Moreover, the increasing integration of capital markets was at that time eroding the capacity of national authorities to engage in expansionary policies - especially at a time in which international price-setters (such as the USA or Germany) followed interest rate policies geared to quell inflation. Finally, international competitiveness had gained in relevance along qualitatively new dimensions - as a result both of an expanding European common market and a growing number of newly industrialized countries which threatened to undermine the competitive advantage of the most advanced countries.

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<sup>2</sup> See Martin (1979) and Esping-Andersen (1985).

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Southern European socialist experiences therefore pose the following practical and theoretical questions: Is it still possible to develop a truly socialdemocratic strategy - namely a strategy that employs the public sector to reduce social inequalities while sustaining economic efficiency? Are there any inherent limits to that strategy under the specific structural and political conditions faced by socialist parties in post-oil shock countries? And, finally, to what extent is it possible to develop and perpetuate the electoral coalition and the political project along the lines of the 'traditional' socialdemocratic ideal model?

The remarkably long control of the Spanish government by the socialist party provides us with a clear case to probe and respond to these questions. To answer them, the paper is organized in the following fashion. The first part, "The PSOE's Economic Strategy," conducts an overview of the overall economic strategy the PSOE developed after 1982 - which combined a firm commitment to a policy of macroeconomic stability and low inflation with an attempt to shape through the public sector the stock of Spanish physical and human capital to increase the economy's productivity and competitiveness. The second part, "Political and Institutional Barriers to the PSOE's Economic Strategy," uncovers two fundamental limits to the PSOE's policies - the organization of the Spanish economy and the distribution of political preferences within the electorate. The third part, "Political Consequences: The Fortunes of the Socialist Electoral Coalition," examines the effects of the PSOE's social and economic policies on the size and nature of its electorate. The conclusion reviews the policy and electoral choices made by the PSOE, compares them to the ideal socialdemocratic model sketched above, and offers a tentative assessment of the possible strategies socialists may follow in the future.

## **THE PSOE'S ECONOMIC STRATEGY**

## **A Stable Macroeconomic Framework**

In spite of generic promises made during the electoral campaign that a future socialist government would engage in a reflationary attempt, the González government immediately rejected the implementation of countercyclical policies to boost internal demand in the fashion the French socialist government had essayed just a year before.<sup>3</sup> Starting with a first set of measures in December 1982 that included the devaluation of the peseta, the cabinet instead drafted a so-called package of adjustment measures for the following two years designed to combat the remarkable economic disequilibria that were thought to hamper economic growth in the medium-term. Emphasizing price and wage moderation and the restoration of profit margins as a precondition for economic recovery, the González government reversed the broadly accommodative monetary policy implemented under the centrist administration (Argandoña 1990; Banco de España 1983) and *Hacienda* vowed to fight a growing public deficit. This macroeconomic strategy was partially bolstered, in 1983 and then again in 1985-86, by national pacts in which unions reluctantly gave support to wage restraint.<sup>4</sup>

The initial dismissal of countercyclical demand management in favor of a

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<sup>3</sup> The PSOE's electoral manifesto explicitly called for an "expansive policy" (PSOE 1982: 7). As discussed by Maravall, himself a minister in the González government, "in spite of the economic crisis, in the summer of 1982 and before the general elections in October González still believed that the future government would have a considerable margin of maneuver for expansion, for increases in public expenditure, and for substantial job creation" but "by September the future minister of the economy, Miguel Boyer, gradually came to know the real depth of the crisis" (Maravall, 1993: 95) and therefore the need to avoid pure counter-cyclical measures. In fact, Boyer, who had not participated in the elaboration of the manifesto, was quick to emphasize in press declarations, made after the electoral victory and before the formation of government, that the socialist cabinet would not pursue "either a stabilization policy or an intense expansive policy." (*El País*, November 24th and 27th, 1982)

<sup>4</sup> In the 1985-86, UGT's assent to wage moderation was compensated with slightly looser macroeconomic policies by the socialist government.



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more rigorous macroeconomic policy can be traced back to two sets of factors. First, the Spanish academic community, and as a result most of the policy-making elite, progressively accepted that the country's persistent poor economic performance over the last decade derived from structural factors that could not be solved by merely boosting internal demand and that the progressive internationalization of advanced economies had altered significantly the conduct of macroeconomic policy-making. Second, this theoretical shift was then vindicated in practice, in the eyes of the Spanish socialist government, by the fiasco of the French socialist experience of 1981-82.

In the aftermath of the first oil shock, a Keynesian countercyclical strategy linked to social compensation policies (through tax reforms and an increase in public expenditure) was drafted by some economists in 1975-77, adopted by the annual reports published by the Bank of Spain and then endorsed by the 1977 OECD annual survey on Spain. This plan squared well with the need to sustain social peace to complete the democratic transition successfully and Fuentes Quintana implemented it as the minister of Economy in the first democratically elected government. Nonetheless, the combination of a sluggish rate of economic growth, a new external shock that undermined the chance to sustain countercyclical policies, and the realization that macroeconomic management was not enough to restore national competitiveness, led to the creation of a new consensus among the economics profession. By 1980, a set of influential papers, many of them by former supporters of demand management policies, were echoing the growing concern in the rest of Europe about the role of structural factors and the need to adopt financially sound policies. The economic turmoil suffered by Spain in the late seventies turned out to be defined as a 'supply-side' crisis produced by a strong growth of real wages endangering profits and thus the creation of net employment (Rojo 1981; also Fuentes 1979). Several annual reports of the Bank of Spain accepted this interpretation by the early eighties and called

for the curtailment of inflation, the moderation of wage costs and the reduction of the public deficit.<sup>5 6</sup> The overall consensus among Spanish economists about the causes of the crisis translated directly into the economic team nominated by González in 1982 which would control the ministry of Economy and Finance and its related ministries throughout the decade.<sup>7 8</sup> Designing and carrying out a non-expansionary macroeconomic strategy created strong tensions within the party and in its relation to the socialist union (in the mid and late eighties). But it was always clear that those opposed to a prolonged stabilizing macroeconomic policy, even within the governing party, were unable to come up with a credible and, from a technical point of view, rigorous policy alternative.<sup>9</sup>

This fundamental shift in policy ideas among academic circles coincided with the direct experience the socialist government had from other European countries. The fiasco of the French experience a year before convinced the

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<sup>5</sup> See, for example, the 1983 annual report (pp. 56 and ff. and pp. 141 and ff.) and the 1984 annual report (pp. 22 and ff).

<sup>6</sup> For a more detailed account of this change of ideas among economists, see Serrano and Costas (1988). For a self-conscious analysis of this process of change from a Keynesian to a broadly defined neoclassical understanding of the state of the economy, see Rojo (1986).

<sup>7</sup> Both Boyer (minister of Economy from 1982 to 1985) and Solchaga (minister of Economy from 1985 to 1993) were professional economists that had pertained to the moderate wing of the socialist party, had notable links with the Spanish policy-making elite in Madrid (in the central bank, ministry of Economy and public corporations) and, particularly the former, had developed strong relations to the 'socialdemocratic' wing of the previous centrist government. For an analysis of their trajectory, see *El País*, November, 27th, 1982, pp. 15-16.

<sup>8</sup> In drafting the first, short-term response to the crisis, the government showed a clear consensus (Sevilla 1985). When Sevilla Segura, one of the few voices within the economic team that was in favor of a more interventionist policy that would use tax policies to force private savings to invest in highly 'productive' sectors, was dismissed in January 1984, the economic team within government was completely in the hands of those favoring an orthodox approach to macroeconomic management.

<sup>9</sup> This position ended up being accepted by the mainstream sector of the PSOE. In the programmatic renewal movement mainly sponsored by the center-to-left branch of the party in the late eighties and which crystallized in the so-called Programa 2000, one-country demand-management policies were definitely and explicitly rejected (see Programa 2000 (1988), particularly p.30).

government that expansionary policies could only be attempted by one country alone at the risk of incurring high economic, as well as electoral, costs.<sup>10 11</sup> The calamitous Labor administration in Britain in the late seventies served as well as a warning against expansionary strategies.

The broad convergence among economists on the diagnosis of the crisis was reinforced by the economic constraints faced by the Spanish economy. From a purely technical point of view, the existing huge public and trade deficits left the government with little room to maneuver.

The cabinet's initial determination to sustain stable macroeconomic policies was bolstered throughout the decade by the growing concern shared by top government officials about the overall competitiveness of the Spanish economy in the world market. It was the increasing economic openness of the Spanish economy and, more particularly, the integration process into the European Community after 1986, that eventually reinforced the cabinet's and party's commitment to a policy paradigm in which competitiveness was the fundamental objective to be achieved through low inflation, balanced macroeconomic aggregates and structural reforms in the domestic market.<sup>12</sup>

In a way reminiscent of the trade-offs encountered by Mitterrand in 1982-

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<sup>10</sup> See the declarations of the minister of Economy during 1983 (Boyer 1983a, 1983b, 1984) as well as the later interpretation by one of the main members of his economic team (Borrell 1990).

For a more technical analysis, see the Medium-Term Economic Plan prepared by the government (PEMP 1985, vol. 1, p.8), and Guillermo de la Dehesa, Secretary of State for Economy through 1988, in *Leviatán*, a theoretical journal linked to the PSOE (Dehesa, 1988, especially p.30), where he especially underlines the external constraints to any expansionary macroeconomic policy.

<sup>11</sup> By November 1981 the French Finance Minister had indicated that it was necessary "to pause before announcing further reforms." By June 1982, that is, several months before González was elected, the French government abandoned its macroeconomic policy and implemented an austerity plan. The deflationary strategy was strengthened in the Spring of 1983. See Hall 1986: 199-201.

<sup>12</sup> For the position of the cabinet, see Dehesa (1988) and Solchaga (1990). For the party, see Programa 2000 (1988: 30).

1983, the Spanish cabinet acknowledged that if Spain were to reap the benefits of its economic and political integration into Europe, it had to submit to the anti-inflationary policies pursued by all other European countries at that time. But, unlike the French case, in which there was a clear-cut intragovernmental confrontation between those in favor of loosening the European ties to regain policy autonomy and those promoting fiscal austerity within the Community (cf. Hall 1986), the Spanish socialist government never seriously doubted sacrificing its national sovereignty in the area of macroeconomic management.

González had strong political and economic incentives to adhere wholeheartedly to the European project. Joining the European Community enjoyed overwhelming public support, mostly derived from a general belief linking the integration into Europe to the culmination of the modernization process of the country. Moreover, the political and business elites strongly agreed that entry to the European Community would yield strong benefits to the Spanish economy -a vast market and a place to look for readily available capital.

The project of European integration necessarily reinforced over time an economic policy concerned with enhancing the level of national competitiveness through the achievement of low inflation.<sup>13</sup> The integration into a vast economic market progressively characterized by the free circulation of goods and capitals weakened the capacity to fall back into engineering an isolated expansion. The inflationary costs of the latter -which were almost certain to happen unless inflation was checked by a social compact guaranteeing moderate wage increases- could only be eased through currency devaluations. Yet a devaluation was perceived to clash directly with the European economic and political project, to threaten the credibility of the governmental commitment to balanced long-term growth and to imperil those capital inflows still essential to sustain Spain's growth

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<sup>13</sup> The expression of 'national competitiveness through low inflation' is borrowed from Blanchard and Muet (1993).

rates. Thus, the achievement of real competitiveness in the framework of a common market required thorough governmental efforts to fight inflation.<sup>14</sup>

To complete this gradual disinflationary strategy, the Spanish government eventually decided to join the EMS in June 1989. It was obvious to the socialist cabinet that the combination of a system of fixed exchange rates and the progressive removal of all barriers to capital movements implied surrendering all its autonomy in the determination of the exchange rate, and thus in the area of monetary policy.<sup>15</sup> Barred from employing a devaluation, all macroeconomic instruments had to be directed towards pushing the Spanish inflation rate to the same level that the core of the Community was experiencing since, "in a system of fixed exchange rates, maintaining an inflation rate higher than our economic environment would only lead to worsen our competitiveness" (Zabalza 1990: 59).

### **The Structural Weaknesses of the Spanish Economy**

To the government's economic team the sluggish performance of the Spanish economy in recent years derived from weak structural conditions that could not be permanently remedied by engineering temporary expansions. The current levels of massive unemployment and low capital investment as well as a widening income gap with other advanced nations could only be reduced in a permanent basis if the supply conditions of the economy were improved. In other words, the country could only be pushed into a higher growth path if the total levels of savings and the volume of capital stock in the economy were increased,

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<sup>14</sup> See Solchaga (1986b), particularly p.31 ff.

<sup>15</sup> A detailed, self-conscious discussion of the policy consequences of this regime by the then Deputy Minister for Planning and Budgeting can be found in Zabalza (1990).

either directly or through the correct manipulation of the conditions that underlie and sustain them.<sup>16</sup>

In the words of Antoni Zabalza, then General Secretary for Planning and Budgeting, there were two fundamental disequilibria that hampered long-term growth in the Spanish case:

"...the high level of unemployment and a great shortage of social capital. Both are structural disequilibria in the purest sense. The former hinders the capacity of the economy to use all its potential resources, the latter seriously constrains our competitiveness, and both of them lead, in several ways, to a dramatic reduction of our potential for growth." (Zabalza 1989, p.30)

Mainly as a result of serious supply bottlenecks, the economic crisis had hit Spain more strongly than other countries. After the two oil shocks, unemployment had ended up almost doubling the EC average. Thus, even if the government had chosen to expand the internal demand without limits, unemployment, for that matter, would not have been absorbed:

"...given the existing technology level, the empirical evidence appears to suggest that Spain does not enjoy enough capital stock to employ all the available labor force. Therefore, for a given technology, the productive capacity of the country can only grow insofar as its capital stock grows." (Ibid., p.35)

Moreover, the capital shortage was thought to contribute decisively to the relative underdevelopment of most areas of the country in relation to Europe. In 1984 the per capita income in sixteen out of seventeen regions was less than 75 per cent of the average per capita income in the EC. Moreover, the internal

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<sup>16</sup> See the opinion of Antoni Zabalza, then Secretary of State for Finance, for whom "the stress on fiscal policy-making was displaced from the short- to the medium-term, as a reflection of an increasing concern with the consequences of fiscal policy on resource allocation, on the growth of capital stock in the economy and, in short, with the possibilities of long-term growth" (Zabalza 1991b: 32). See as well the analysis of Pedro Pérez in 1989, then Secretary of State for the Economy, in Pérez and Ruiz (1989).

distribution of wealth was strongly unequal. The income level among all Spanish regions was widely divergent - the per capita income in the richest regions was more than twice the per capita income in the poorest areas.

Increasing investment turned out to be a must. Only by investing could the potential productive capacity of the economy be raised and these secular disequilibria overcome. From a socialdemocratic perspective, this unquestionably called for granting an active role to the public sector in the expansion of the Spanish supply factors - both for reasons of economic efficiency and political fairness.

On the one hand, since both underdevelopment and joblessness were understood as secular phenomena, which the spontaneous action of markets have apparently not diminished but aggravated, the public sector had to be called in to remedy these economic disequilibria. Moreover, since the internationalization of the Spanish economy, furthered by the process of European integration, was undercutting the traditional resort to an exchange rate policy in order to increase competitiveness, the cost of production factors as well as their productivity were becoming the fundamental variables that determined the competitive edge of Spanish companies. As a result, the socialist government believed that, in order to solve the secular failure of Spanish private agents to amass a sufficient level of capital stock, the state should intervene in the investment process and break the supply constraints that tied up the economy.<sup>17</sup>

Public capital formation would have to focus, on the one hand, on investing in physical capital, since "there are a set of investments of a strategic kind, such as those on basic infrastructures and on transportation that have a direct effect on the growth potential of the economy and consequently on the supply side" (Zabalza 1988c: 268). But, in order to regain in international competitiveness -through a

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<sup>17</sup> See Zabalza (1988a, 1988b, 1988c), Solchaga (1987, 1988).

high productivity/high wages strategy, accelerate economic growth and reduce structural unemployment, it should be similarly directed towards education, research and manpower policies to upgrade the quality of Spanish workers (Zabalza 1991b). To sum up, public spending to enhance the national stock and to make private returns attractive enough were believed to be a sound strategy among top socialist economic policy-makers, for whom "...the capacity of the economy to attract economic activity will depend on the value of its productive factors (...) In this context, the fiscal policy plays a larger role as an instrument to create competitiveness since it is possible to affect all key business decisions by transforming and altering the supply of all local productive factors" (Zabalza 1991b: 39-40).

On the other hand, an interventionist policy fulfilled the socialist pledge to ensure fair growth across all regions and social sectors and to redistribute economic wealth. If public investment could lessen the existing structural barriers to growth and therefore reduce unemployment, it would mean improving the life chances of a vast section of the population. From a strict redistributive point of view, the public control of investment could be nicely targeted to accelerate the rate of growth in the most underdeveloped regions (Zaragoza 1989) and to alleviate the unequal territorial distribution of resources in Spain. Similarly, an increased effort on human capital formation had a clear redistributive function: it was "an important part of a social policy directed to accelerate the vertical ascent of specific social sectors." (Solchaga 1988: 24)<sup>18</sup>

As a result of the way in which this public capital formation strategy responded equally to the issues of economic efficiency and social fairness, it had the capacity to reconcile the constellation of diverse political interests and factions

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<sup>18</sup> Notice, as well, that growth (and employment) could have been pursued through a low labor costs strategy. But this would have probably come at the expense of politically unbearable reductions in wages and of increasing social inequality.



within the PSOE and its political constituencies. It seemed a plausible and even necessary way to speed up the rate of economic growth without sacrificing the overall macroeconomic equilibria that the moderate wing of the party and the economic team in government believed vital in order to link Spain to Europe and to spur private investment. At the same time, the likely redistributive effects of transferring vast sums of money into less developed areas and social groups responded to the resolute demands of the radical wing of the party. Increasing the standards of living in the less developed areas of the country, which were important socialist strongholds, appeared to secure the electoral support needed to sustain the PSOE in power.

### **The Development of a Socialdemocratic Supply-Side Economic Strategy**

To develop an economic strategy relying on the state to raise the levels of capital formation, both human and physical, the government started by gradually raising tax revenues - from 32.4 per cent of GDP in 1982 to 40.1 per cent of GDP in 1991. Most of the new revenues were first applied to lower the public deficit and hence to increase the level of public (and therefore total) savings.<sup>19 20</sup> Once the public deficit had been significantly contained by 1987-88, all new public resources were channelled to expand the stock of physical capital and to expand general education and vocational training programs - even if that meant sacrificing the

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<sup>19</sup> See Zabalza (1990, 1991a) for a critique of the idea that a mere increase of private savings (achieved through tax cuts) would mechanically translate into higher investment rates; and for a defense of an alternative strategy based on building up public savings and directing them to the formation of capital stock through the budget.

<sup>20</sup> A reduction of the public deficit was also defended as it "freed money for the private sector and allowed for the strengthening of investment in that sector," (Solchaga 1986b, p.23) and created room for a considerable loosening of monetary policy and thus for a corresponding fall in the costs of capital. (Solchaga 1986: 30)

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social component of the public budget. Table 1 shows in a compact way the bare bones of the socialist strategy. The new resources obtained in the eighties (that is, 7.7 percentage points of GDP), jointly with expenditure saved from other areas, were heavily directed to improve the stance of the Spanish supply aggregates (4.1 percentage points of GDP). The public deficit was slightly reduced by 1 percentage point - still, these figures are somewhat distorted by a sudden increase in the public deficit in 1990-91, since by 1989 the public deficit was standing at -2.8 per cent of GDP or half its size in 1986. Within capital investment, physical and human capital were evenly increased: fixed capital formation was steadily increased by 2.1 points of GDP up to 5.2 per cent of GDP in 1991; 2 percentages points were allocated to both general education expenditure and new manpower programs.

**Table 1.** *General Government Expenditure and Public Capital Formation*

	Level of expenditure (% of GDP)				Change 82-91 (% of GDP)
	1982	1986	1989	1991	
Total Revenues	32.4	36.1	39.8	40.1	+7.7
Budget Stance	-5.6	-6.0	-2.8	-4.9	+0.7
Total Capital Formation	6.3	8.0	9.4	10.4	+4.1
Fixed Capital	3.1	3.6	4.4	5.2	+2.1
Education	3.0	3.8	4.1	4.2	+1.2
Active Labor Policies	0.2	0.6	0.9	1.0	+0.8
Social Expenditure	18.4	18.6	18.7	20.4	+2.0
Public Debt Interests	1.0	4.0	3.5	4.0	+3.0
Subsidies and Capital Tranfers	5.5	3.6	3.6	3.6	-1.9

Source: "Apéndice Estadístico" in Lagares (1992), pp. 162-166, except data for active labor policies, derived from García Perea and Gómez (1993).

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*The Pre-Condition for Success. A Socialdemocratic Tax Strategy*

Although government revenues had increased strongly in the late seventies, boosted by a comprehensive tax reform approved in 1977-78, they had not kept up with the rate of increase in spending, driven by a weak economy and the political pressures of the transition process. Therefore they had been insufficient to contain a deteriorating public deficit. As a result, raising tax revenues stood as a necessary condition to hold together the González economic strategy that intended to combine a stable macroeconomic policy and the state's direct intervention in capital formation and economic growth.

Driven by its electoral commitments and economic plans but constrained by a delicate economic situation, the González government designed a medium-term strategy to raise fiscal revenues over the decade. To avoid sparking much opposition on a highly contentious issue, the government never put into question the public consensus that had been built around the tax reforms enacted in the seventies. It rather used the latter to accomplish its partisan objectives incrementally. On the one hand, it successfully launched a strong effort to combat pervasive fiscal fraud. By 1990 the number of tax returns being filed had jumped to almost 11 million - therefore nearly doubling the figures of 1981. Moreover, the total tax base grew in ten years by 6.4 per cent annually in real terms. By 1990 the national tax base was almost twice that of 1981 measured in constant pesetas. In the same period, the Spanish GDP had increased by 40 per cent in real terms.<sup>21</sup>

On the other hand, the Spanish government raised revenue mostly through fiscal drag, which was then unequally corrected across tax brackets to enhance the overall progressivity of the tax system - a goal forcefully defended by the socialist

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<sup>21</sup> All data are for Spain excluding the Basque Country and Navarra.

party.<sup>22</sup>

After ten years of incremental reform, the tax strategy of the government achieved the two fundamental goals that characterized the socialist manifesto of 1982. Revenues had surged markedly and the overall progressivity of the tax had been strengthened decisively.

In nine years revenues jumped 7.7 points of GDP (or a relative increase of 24 per cent) from 32.4 per cent of GDP in 1982 to 40.1 per cent in 1991 - thereby putting Spain on almost equal terms with other medium-size European nations in relation to the size of fiscal revenues.<sup>23</sup> Making good on the promise to enhance the redistributive structure of the tax system, the increase was heavily concentrated on direct taxes. Almost two thirds of the increase derived from higher personal and corporate income taxes (5.3 points of GDP or a relative increase of 80 per cent). Most of the rest came from consumption taxes as a consequence of the introduction of the VAT required by Spanish integration into the European Community.

Overall progressivity deepened strikingly in less than a decade. Graph 1 displays the effective tax rate, that is, the percentage of the tax base paid to the state after all deductions and allowances have been taken away, paid in 1981 and 1990 for incomes up to Pta. 10 million in 1981 pesetas.<sup>24</sup> In 1981, the effective tax

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<sup>22</sup> See PSOE 1982: 18; Programa 2000 1988: 163. See also Solchaga 1986a: 214 ff.), Borrell (1987, 1988, 1989).

<sup>23</sup> Although the level of taxation appears to be similar to or smaller than other European countries, it is probably higher when one accounts for the Spanish real per capita income. Since the latter is much smaller than more advanced countries and therefore its capacity to finance consumption and savings is presumably lower, the fiscal detraction suffered by the Spanish taxpayers turns out to be higher than in other countries. Thus, in 1990, real per capita income was around \$ 5,200 (at the price levels and exchange rates of 1985) and tax revenues were 35 per cent of GDP. A similar proportion of tax revenues over the GDP was only reached in Sweden in 1965 when per capita income was over \$ 8,000 (again at the price levels and exchange rates of 1985); in Germany in 1972 when per capita income was \$ 7,800; or in Italy in 1985 when per capita income came close to \$ 7,500. All estimations are own based on data from OECD (1991).

<sup>24</sup> Estimations are derived from the data collected in IGAE (1991).

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rate on an income of Pta 500,000 was 5.4 per cent. For an income ten times larger, the effective tax rate was 21 per cent.<sup>25</sup> The effective tax rate reached 30 per cent only when the income exceeded Pta. 9 million. Ten years later tax rates had gone up for all incomes over Pta 700,000 (always in 1981 Pta. which would be Pta. 1,478,000 in nominal terms in 1990). The real progressivity of the tax had increased substantially as well. For an income of Pta. 9 million (in 1981 pesetas) the effective tax rate was around 42 per cent.

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<sup>25</sup> Less than one per cent of all taxpayers were under that category.

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### *Public Savings*

Progress to reduce the public deficit and increase public savings was both slower and more volatile. During the first parliamentary term, the public deficit slightly increased as a result of the expansionary measures approved in 1985. The government was able, however, to tackle some of the underlying causes of an excessive deficit. The budgetary process was rationalized and the structure of personnel costs was clarified. The government enacted a reform of the Social Security system that slashed current benefits, shifted some contributions to employees and stepped up the fight against relatively wide spread fraud. It restructured the sector of state-owned industries whose losses had risen from about 0.3 per cent of GDP in 1977 to over 1.5 per cent of GDP. As a result, social benefits other than pensions fell 1.3 percentage points of GDP from 1982 to 1986. Subsidies and capital transfers were cut by a third.

Once the business cycle improved and tax revenues grew accordingly, a considerable proportion of the latter was directly applied to reduce the deficit - even if that effort compromised the PSOE's political program to enlarge public services and threatened to damage the electoral standing of the government among its supporters. According to the estimates presented by the Secretary of State for Finance, between 1985 and 1990, 83 per cent of all net tax increases (i.e. tax increases minus new public transfers), which grew 4.7 points of GDP, were applied to reduce the public deficit (Zabalza 1991c). Public savings increased from -1.4 per cent of GDP in 1985 to 2.9 per cent in 1989. Still, these results proved to be the most fragile part of the PSOE's policies. As discussed later, by the late eighties strong political pressures radically upset the budget balance.



### *Expanding the Public Stock of Physical Capital*

Once the economic trough of the early eighties was left behind and the budget deficit started to decrease, the government decided to press ahead with what would become the core of its supply-side strategy - building what was termed a 'national stock of public capital'.

Although the volume of public direct capital investment was increased in 1985 and 1986 to sustain a temporary expansionary policy, it was slightly curtailed in 1987 to accommodate a strong cut in the public deficit. It was from the 1988 budget on that public investment rose steadily - by almost half a point of GDP every year - to reach more than 5 per cent of GDP in 1991. Although some of this increase was decided by the regional and local governments (around a fifth), most of it (more than two thirds) was the result of the ambitious investment strategy approved by the central government.<sup>26</sup>

Most of all public investment spent by the central government was allocated

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<sup>26</sup> As a consequence of the constitutional devolution of powers to regional governments implemented in the early eighties, the structure of public investment underwent some changes through the decade.

In 1980 70 per cent of all public capital formation was produced by the central government and nearly all the rest was allocated by local governments. By 1985 regional governments were controlling a third of all public investment (around one point of GDP). Nonetheless, at least half of this investment came from a national fund (the 'Fondo de Compensación Interterritorial' or FCI) whose volume depended on the level of investment approved by Madrid (by law nearly 30 per cent of all the central government non-military investment was automatically channelled through the FCI) and was allocated following strict redistributive criteria (bargained between the central and regional governments).

Once the devolution process slowed down and the policy to contain the public deficit was relaxed, the central government investment began to gain in importance again. Most of the increase in public capital formation (about two thirds) came directly from Madrid; approximately a fifth of it was decided by the territorial governments and the rest derived from a slight increase in the FCI. By 1990-1991, the central government controlled (directly) 45 per cent of all public capital formation; if we add to this the investment channelled through the FCI (paid by Madrid but administered by regional governments), the central government was still controlling 55 per cent of all investment.

All figure are own estimations based on IGAE (1993) and Banco de España, *Anuario Estadístico* (several years).

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to build or ameliorate those basic infrastructures that were thought to play a key role in linking the country (and specially the less developed regions) to the European market, increasing overall productivity and therefore offering more incentives to private investment, and helping to overcome acute shortage and demand bottlenecks. Accordingly, the government developed a comprehensive set of plans to improve transport and communication networks. The construction and maintenance of roads, railroads, ports, airports and urban networks represented more than half of the investment assumed by the central government. Another tenth of all the investment was directed to the extension of dams and irrigation systems. The rest was mainly employed in education and health infrastructure and, only secondarily, in culture, housing and environmental protection.<sup>27</sup>

### *Human Capital Formation*

Most of the public effort on human capital formation took the form of increased expenditures on general education. Thus, public expenditure in education, that represented 3 per cent of GDP in 1980, was steadily increased to 4.2 per cent of GDP in 1991 - an increase second only to public investment and higher than social expenditure in areas such as health and pensions. Besides a strong boost in expenditure, the socialist government decided to reorganize primary and secondary education (through legislation in 1985 and 1990) and extend free and compulsory education until the age of 16 (in 1990), and attempted

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<sup>27</sup> All these proportions refer to central government non-military investment and they include investment by all autonomous institutes (*Organismos Autónomos*) and the Social Security.

Military investment, that has declined over time, represented 0.8 per cent of GDP in 1987 and 0.5 per cent of GDP in 1990 (IGAE 1990).

Besides direct public investment, the central government has financed investment by private and public enterprises through capital transfers - which have fluctuated around 2 per cent of GDP.

to revamp the university system (through a new law in 1983). Combined with a declining rate of population growth, the rise in educational expenditure meant doubling the amount spent per student in real terms, a vast expansion in teachers' hirings and the extension of education in secondary and university levels (Puerto 1991).<sup>28</sup> The proportion of students from 14 to 18 years attending school went up from 50 per cent in 1980 to 70 per cent in 1989 and from 19 to 23 years went up from 22 to 33.1 per cent.<sup>29</sup> The volume of grants and scholarships was multiplied by six between 1982 and 1992 from Pta. 12 Billion to Pta. 71 Billion and the number of beneficiaries went from close to 500,000 in 1987 to more than 800,000 in 1992 (Riviere and Rueda 1993). Finally, the socialist government attempted to strengthen the system of vocational education ('formación profesional' - FP), by adapting it to the demands of the marketplace and by giving it more status within the overall education system. In ten years, the number of students in FP doubled (CIDE 1992).

Active labor market policies took off later. A first attempt came through the promotion of specific training contracts, approved with the assent of unions at the time of the social compact of 1984-86. From 1984 to 1992, around 10 per cent of all hirings corresponded to training and apprenticeship contracts (or 20 per cent of all hirings made under specific employment promotion schemes). Albeit at first timidly, the socialist cabinet also embarked on active manpower policies narrowly defined. In 1983, they totalled Pta. 53.4 million in 1983, that is, around 12 per cent of all expenditure on labor market policies (the rest consisted of unemployment benefits) and 0.25 per cent of GDP. Moreover, they were mostly focused on a rather disparate set of incentive systems and schemes for the private sector. As a result of the social compact of 1984, their volume more than doubled in a single year and by

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<sup>28</sup> Around 80 per cent of the new expenditure in education was directed to secondary and university education, according to data collected by Bandrés (1993) comparing 1980 to 1990.

<sup>29</sup> All children between 6 and 12 years were already attending school in 1980.

1986 they amounted to 0.64 per cent of GDP. By 1991 they had reached 1.03 per cent of GDP.<sup>30</sup> Their composition changed as well. Around a third still consisted of applying unemployment subsidies to finance workers' entrepreneurial projects (Espina 1991). Yet by 1987-88 almost a third of the expenditure in manpower policies was directed to vocational training programs. The so-called 'occupational vocational education' scheme ('formación profesional ocupacional'), created in 1985 to train workers in very specific jobs (compared to the general skills provided through FP), would multiply by four in few years to reach almost 350,000 people in 1988 (Corugedo et al. 1991).

### *Capital Formation and Public Businesses*

Albeit more timidly, the Spanish public business sector was also drawn into the set of interventionist strategies designed by the socialist government in two ways. On the one hand, capital investment was thoroughly raised in several sectors controlled by public companies in order to supplement the current fiscal strategy aimed at ensuring high levels of fixed capital formation in Spain. On the other hand, the cabinet decided to press ahead with the idea of turning some public corporations into strong national champions capable of competing abroad, opening new markets for other Spanish businesses and supplying new technologies to Spain.

In line with the persistent determination of the Spanish economic policy-makers to substitute long-term supply-side strategies for discredited demand-management solutions, the public business sector was progressively granted a new

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<sup>30</sup> These programs were also spurred by European funds, which financed 52 per cent of all of them (Espina 1991).

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function in the Spanish economy. Its role in boosting demand, acting as a counter-cyclical tool and providing employment, was systematically abandoned. Employment in state-owned companies was cut over time - by more than one third in RENFE and INI. The government strove to reduce the amount of public money being wasted in loss-making companies.<sup>31</sup> State transfers to public corporations were gradually reduced over time from 3 per cent of GDP in 1983 to 1.1 per cent of GDP in 1991. Through the mid eighties the government privatized companies marginal to the core businesses of INI and INH (most of them socialized in the previous decade). In exchange, the socialist cabinet openly used key public companies to accelerate the process of public formation already implemented through the central government budget. Graph 2 shows, in a comparative manner, the annual change in real terms in the level of gross fixed capital formation by the general government, by all public enterprises and by the private sector *strictu sensu* (i.e. once the public enterprises are excluded from the latter).

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<sup>31</sup> It is true, however, that the government continued to sustain some heavily loss-making sectors. This was, for example, the case for the coal mining industry (Servén 1989), heavily concentrated in one region, Asturias, in which employment in the public holding amounted to 44 per cent of all industrial employment (the data corresponds to 1976 and is reproduced in Martín and Comín (1990)).

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Capital formation in the public enterprise sector almost matched that of the private sector until 1986-87 - although its decline was sharper in 1984-85. This reflected a period in which public enterprises underwent a thorough process of rationalization in personnel and production systems. Yet from 1987 on, the rate of change in capital investment by public enterprises accelerated steadily. It first followed closely the pace of growth in capital formation by the general government to outstrip it by 1989. In 1988 and 1989 investment by public companies increased above 20 per cent in real terms. From 1988 on, the rate of change (in real terms) in capital formation in the public enterprise sector would double the rate in the private sector.

Responding to the general supply-side concerns of the government (jointly with its medium-term strategy of favoring the internationalization of some companies), the investment effort in the public sector followed a distinctive pattern. Capital formation was directed to the telecommunications sector (Telefónica tripled its investment in real terms from 1986 to 1990), internal transportation through railways (the state-owned railways company -RENFE- tripled its investment too in the same time period),<sup>32</sup> oil and gas (INH's investment in 1990 was 2.5 times bigger than in 1986 in real terms) and air and sea transport (investment grew eight times from 1986 to 1990 in real terms). All other sectors, that included more traditional or industrial business lines such as steel, mining, aluminium or ship-building, had their rates of investment unchanged or even curtailed (always in real terms). Parallel to increasing material investment, public companies made an important and well publicized effort in human capital formation: INI doubled its expenditure on R & D to 2 per cent of its total sales in those years - putting it above the European average and in terms similar to other big European industrial concerns.

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<sup>32</sup> This excludes capital transfers from the state.

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The investment buildup was related in several cases to the cabinet's attempt to launch certain companies into leading positions in the world market. In order to build something akin to a set of 'national champions', the government continued, in the first place, to pursue a strategy of rationalization and concentration of business lines around strong companies: the predominant position in the domestic market of Endesa, the electricity subholding company, was reinforced; the electronics sector was definitely organized around Inisel through several mergers and shares' exchanges; the government made sure that INH would keep its solid position in the area of oil and gas production and distribution after the process of European integration injected competition in the sector; in 1991 all state banks were merged into CBE ('Corporación Bancaria de España' - later 'Argentaria CBE') to form the third largest banking group in the Spanish financial sector. In the second place, the public enterprise sector expanded its participation into transnational -mostly European- joint ventures in order to gain a foothold in foreign markets and to improve its technical capacity. Finally, the state business sector followed a direct and ambitious strategy of internationalization through the purchase of foreign firms to build up enough economies of scale to remain competitive in the world market.

Still, the process of internationalization had a limited character. Although important, the Spanish public enterprise sector lacked the size and the competitive edge of the French one. Even after the privatization drive of 1986-1988, the French state controlled world leaders such as P  chiney, Rhone-Poulenc, Saint-Gobain, Thompson or Renault. Instead, the Spanish public industrial sector mostly comprise mid-sized companies, by world standards. Moreover, most of them pertained to declining sectors such as steel or aluminium that faced fierce competition from other developing nations that enjoyed cheaper labor costs. Engaging in a long-term, aggressive industrial policy in those industries was out of the question. The public budget was constrained by the goals of deficit



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containment, direct capital formation and new social programs. The EC laws on competition left scarce room for massive public aid. Thus, the Spanish strategy of internationalization had to rely upon a different set of companies, located in areas such as services or telecommunications. The government hoped to turn Iberia into a strong international carrier through several joint ventures and, above all, an aggressive medium-term strategy to capture the Latin American market. A substantial investment was made to turn Miami into a vast air hub, and Iberia bought stakes to control several South American companies - Viasa, Ladeco and Aerolíneas Argentinas. Telefónica, the telecommunications company, made similar strenuous efforts to penetrate new countries, such as Argentina, Chile and Venezuela in the late eighties and Puerto Rico, Portugal and Romania in the early nineties. All these acquisitions led to a significant expansion in the volume of business managed by Telefónica by 40 per cent (Telefónica 1992).

## **POLITICAL AND INSTITUTIONAL BARRIERS TO THE PSOE'S ECONOMIC STRATEGY.**

### **Institutional Barriers to Macroeconomic Stability: The Question of Union Cooperation**

To combat inflation in order to enhance national competitiveness and to benefit from the process of European integration fully, it was clear to top government officials that they were left with only two possible policy alternatives.<sup>33</sup> On the one hand, the government could attract unions into a social compact to ensure moderate wage increases and therefore lower inflation. On the

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<sup>33</sup> A straightforward exposition of these two alternatives and their costs and benefits by the minister of Economy himself can be found in the presentation of the Budget for 1989 (Solchaga 1988: 29 ff.), the Budget for 1990 (Solchaga 1990: 33 ff.) and the Budget for 1992 (Solchaga 1991b: 12 ff.).

other hand, were social concertation not available, the cabinet would be forced to quell inflation "through either a more restrictive monetary policy, the exchange rate, appreciating the peseta, or a blunt reduction of public expenditure." (Solchaga 1988: 29)

The first alternative was clearly the preferred course of action to the socialist cabinet. It responded to the traditional socialdemocratic project that included the union movement in the policy-making process in order to build strong welfare policies, and it avoided harsh monetary policies that could alienate an essential part of the socialist electorate.

For that purpose, the government made several attempts at social concertation during the decade. In order to control inflation, the government repeatedly asked the economic agents to accept some form of wage restraint. In exchange for wage moderation, the government promised to negotiate a "social wage", around the "differences in taxation endured by wages and low incomes and by higher incomes; as well as the structure and volume of social expenditure." (Solchaga 1988: 30) And, finally, given the governmental conviction, espoused publicly and supported by official reports, that wages were the main causal component of the inflationary process,<sup>34</sup> a social compact to moderate them appeared to be the most direct and less costly way to reduce inflation.<sup>35</sup>

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<sup>34</sup> See, for example, Solchaga, for whom "labor costs have the most decisive impact on all economic costs" (1988: 29). Similarly, a report prepared by the Ministry of Economy on collective bargaining since 1977 and presented by Guillermo de la Dehesa, then secretary of State for Economic Planning, pointed out that the trade union's excessive concentration on salary increases, with little concern for productivity, had forced employers to reduce their labor force in order to control unit costs. The report ended up recommending wage restraint and more flexibility in wage settlements as a means to increase employment (*El País*, April 9th, 1988).

<sup>35</sup> The governmental attribution of inflation to wage pressure declined, however, in the late eighties. Instead, as the behavior of prices started to diverge between the tradeable and the non-tradeable sectors (close to EC inflation in the former but well above the EC average in the latter), the government started to focus its attention on the second. See Zabalza (1989, 1991a) and Solchaga (1991a). See also OECD 1992: 57-76.

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Incomes policy worked well during 1985-1986 in reducing inflation and sustaining the economic recovery. In the negotiating rounds for 1987, however, the socialist trade union (UGT) disassociated itself from the governmental program for social concertation. As unionists tirelessly stressed, the social concertation of 1985-86 had resulted in a fall in real wages of almost one point yet unemployment had barely decreased. Hence, the UGT leaders asked for a wage increase two points above the official inflation target of 5 per cent for 1987 in order to restore real wages. Denying that wage pressure had any substantial impact on inflation, they urged González to engage in a sustained effort in boosting demand to absorb unemployment. The clash over macroeconomic policies was compounded by growing disagreements on social policies and on the role of the state in the economy, concerning unemployment benefits, pensions and the control of investment.

The government appeared uncompromising. Veering away from what, to that date, had been a predominant pattern of wage moderation, threatened the anti-inflationary policy in course. Furthermore, in the wake of a recovery in fiscal revenues, the reduction of the public deficit to increase the level of national savings and investment had priority over a boost of public consumption and social transfers. Negotiations quickly became sour and a national collective agreement for 1987 turned out to be impossible.

The wage agreements for 1987 between unions and business organizations averaged an increase of 6.5 per cent, therefore close to the UGT demands. Inflation, however, fell 3.5 percentage points to an average 5.3 per cent in 1987 - and by the end of 1987 it had dropped to 4.6 per cent. To government and unions alike, the outcome confirmed their corresponding policy positions. Solchaga, invigorated by the almost perfect match between the planned goal and the actual result, announced an inflation target of 3 per cent for 1988. To the trade unions, instead, the wide gap between wage and price increases definitely upheld their

claim that both were only weakly linked. Consequently, UGT responded to the ambitious government target by asking for pay increases ranging from 4 to 6 per cent in 1988 and by insisting that social expenditures should be strongly expanded. Given the optimal combination of accelerating growth and falling inflation, enjoyed at that time by the Spanish economy, the incentives for a social pact grew dimmer and eventually the prospects for a national agreement waned again.

With demand growing heartily, however, the disinflation process became stalled by the summer of 1988. After reaching an all-out low of 4.4 per cent in the second quarter of 1988, inflation bounced back to 5.7 per cent at the end of the third quarter. The socialist cabinet had to face again, though even more intensely, the dilemma of either attracting trade unions back into a social compact or using stabilizing fiscal and monetary policies alone. Concertation could not come about easily. With inflation running two points above the official target, the cabinet's credibility had been seriously damaged among the social partners. Moreover, encouraged by the expectations generated by the economic boom, unions' demands had radicalized over time. The negotiations between the cabinet and the unions during the summer of 1988 stumbled upon the same obstacles of the previous years. Besides, a youth employment and training scheme to subsidize employers to take on school leavers on short term contracts at the minimum wage was adamantly opposed by the unions. In order to merely open negotiation rounds in the fall, UGT demanded the immediate withdrawal of the scheme, the extension of unemployment coverage and increases in pensions and public sector wages to compensate for higher than expected inflation. With negotiations in stalemate, UGT and the communist union, CCOO, joined in a one-day general strike in December 1988 to bring the government to its knees and to exact from it a set of social concessions whose cost was put at least at Pta. 450 billion (\$ 3.9 billion or

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more than 1 per cent of the 1988 GDP).<sup>36</sup>

Given the extraordinary success of the strike, González promptly conceded the cabinet's defeat in Parliament, and agreed both to shelve the youth employment plan and to adjust pensions and public sector wages to inflation, but rejected the expansion of unemployment coverage levels. After long and tense negotiations at the beginning of 1989, the government decided to stick to the initial offer made by González in December, whose cost was put at Pta. 190 billion (\$ 1.6 billion). At that point, the stable pattern of social concertation established in the mid seventies could be declared irreversibly lost.

The government, however, attempted repeatedly to set up a new social agreement to cool down the economy and to reduce inflation. Explicit calls made by the minister of Economy in July 1989 and by González in August 1989 were rejected by UGT. In response to the entry into the European Community exchange rate system, UGT and CCOO launched a joint platform ("Propuesta Sindical Prioritaria") demanding more extensive social expenditure, greater government planning of the economy, an extensive housing policy and a fairer tax system.

Shortly after formal talks were revived at the beginning of 1990, the government made strong concessions on social issues. Minimum pensions were to be raised up to the minimum wage level in 1990. The government established non contributive pensions. In addition, expenditure on unemployment benefits was sharply expanded, at a time in which joblessness was falling, from 2.7 per cent to 3.8 per cent of GDP in three years. In spite of those unconditional social concessions, all governmental expectations for wage moderation proved illusory. At the beginning of the year the minister of Economy warned that were wages to rise above 7.3 per cent, harsh fiscal and monetary measures must ensue. The first

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<sup>36</sup> The historical development that led to the general strike can be followed through the set of newspaper articles edited by Juliá (1988).

major collective agreement of 1990, in the construction sector, called for a wage rise of 8.5 per cent and all wage settlements during the first quarter of the year averaged 8.3 per cent. Meanwhile, in the UGT's national congress in April 1990, its leader, Nicolás Redondo, assured union representatives that he would keep on with "the syndical strategy begun in 1987: definitive rupture with the PSOE and the maintenance of joint action on wage claims with CCOO." (EIU 1990, 3rd trimester)

Government plans to unveil a global 'competitiveness pact,' aimed at stimulating Spanish productivity in the immediate future, were announced by the summer of 1990. Unions immediately interpreted the proposal as yet another incomes policy to ensure that real wage increases were offset by productivity growth, and, while presenting the budget for 1991, Solchaga had to announce a delay on the negotiations on the pact. Even with economic growth beginning to slow down, the negotiation rounds for 1991 yielded an average wage increase of 8.1 per cent. Pressed by the stringent conditions laid down in Maastricht for the European Union, yet willing to avoid restrictive fiscal and monetary policies, the government eventually presented a competitiveness pact, under the name of 'Social Pact for Progress', in June 1991. The pact insisted in approximating wage increases to the rates prevalent in low inflationary European countries and asked for wage increases to be linked to productivity gains. Yet it asked for salary reviews to be subject to a common clause in order to guarantee that wage earners would see some increase in real incomes. In a departure from a previous position within the government, it called for a set of controls on distributed profits, which could not grow at a pace higher than wages, and designed favorable tax incentives for those profits reinvested in the company. Although further away from a traditional incomes pact to control wages, the 'Social Pact of Progress' failed again to attract the trade unions. Wage settlements for 1992 fluctuated around an increase of 7.2 per cent and, after a renewed period of confrontations, the unions

staged a second one-day general strike in the spring of 1992 - which was, however, mostly a failure.

Now, why did a full, prolonged pattern of coordination between the socialist cabinet and the union movement prove impossible to sustain? As in other Southern European countries -as well as in other medium-size economies, like the UK, in particular in the age of growing economic interdependence-<sup>37</sup> the answer lies in two sets of conditions: the nature of the union movement and the changing policy preferences of socialist parties.

On the one hand, the size, internal composition and institutional arrangements of the Spanish union movement made engaging in a sustained pattern of social concertation highly unlikely. First, union membership in Spain is low -comprising around 16 per cent of all workers- and mainly concentrated among skilled manual workers with permanent contracts in medium and large companies<sup>38</sup> - hence, unions have few incentives to embrace wage restraint in exchange for more employment among temporary and unskilled workers. Recent empirical work shows that during the economic expansion of the late eighties, Spanish skilled workers, who were the first to benefit from supply bottlenecks in the labor market, soon gained political clout and became the main cause of wage pushfulness.<sup>39</sup> In fact, even though the labor movement is small in size, the Spanish legal framework regulating the system of syndical elections and the collective bargaining process amplifies the unions' power in both the labor market

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<sup>37</sup> For evidence of an alignment in Britain similar to the Spanish one, in which unions favor demand management policies while the socialist party has shifted towards active supply-side policies within a framework of macroeconomic stability, see *The Economist*, September 11th, 1993, p.56, "Labour and the Unions. The Price of Peace."

<sup>38</sup> See a CIS' survey reported in *El País*, May 29th, 1989.

<sup>39</sup> For evidence on the pressure exercised by insider, skilled workers in the Spanish wage bargaining process, see Bentolila and Dolado (1993).

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and the political arena considerably.<sup>40</sup> Second, the structure itself of the wage setting system, characterized by annual collective agreements mostly at the sectoral level,<sup>41</sup> hinders the capacity of unions to reach, and comply with, any agreements on wage moderation. In short, small unions, mostly in the hands of 'insiders', negotiating at the sectoral level, and imbued with a radical perception of the role of the state in the economy, could not provide the institutional basis to sustain a corporatist regime of wage moderation in exchange for expansive fiscal policies and a long-term redistributive policy through social transfers.<sup>42</sup>

On the other hand, the policy preferences of socialist parties have changed as a result of the perceived international constraints under which macroeconomic management has to operate and the fiasco of other corporatist experiments in medium-size countries (in particular the United Kingdom). The historical experience of European socialdemocracy, either defeated after being unable to control accelerating inflation in the late seventies -the British case- or forced to turn the expansion around -the French case- had made the PSOE particularly conscious about the political costs of inflationary growth.<sup>43</sup> Hence, even if the

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<sup>40</sup> Partly due to high electoral thresholds in the allocation of workers' representatives according to the results of the syndical elections, UGT and CCOO already controlled three fourths of all syndical delegates by 1986 (*Anuario El País* 1988). Similarly, by the end of the eighties, and despite their low numbers of affiliation, the two main unions, CCOO and UGT, were represented in more than 90 per cent of all collective bargaining tables (Fernández-Castro 1993).

<sup>41</sup> According to OECD (1992: 66), for three-quarters of Spanish workers, wage levels and working conditions are decided at the sectoral level.

<sup>42</sup> On the necessary conditions to sustain neocorporatist settlements, see Goldthorpe (ed.) (1984) and Scharpf (1991).

<sup>43</sup> In addition, the change in the order of preferences might have derived from the fact that the PSOE depended on broad middle-class sectors as well as unorganized working-class voters for which non-inflationary growth might have been more appealing. As shown in the following table, from an electoral point of view, the PSOE appears closer to other socialist parties in medium-size economies (such as Britain) rather than to small countries (such as Sweden):

Percentage of wage earners voting for:	manual	non-	(Source)
		manual	



socialist party still considered a social compact to be the optimal outcome, it abhorred any wage aggressiveness that could endanger its commitment to balanced growth in the medium run. As a matter of fact, the organizational weakness of unions would only foster the cabinet's skepticism about the workers' ability to sustain centralized pacts. In case unions did not abide by a national incomes pact, the socialist cabinet was nearly unyielding about the strategy to pursue. Confronted with wage indiscipline, the government showed no doubts about employing stabilizing policies to quell inflation.<sup>44</sup>

The confrontational relationship between the socialist party and the trade unions endangered the overall economic strategy of the government. On the one hand, it jeopardized the government commitment towards a balanced budget and, as the Ministry of Economy struggled to accommodate those social concessions with the planned budget, it altered in part its effort to foster public investment. On the other hand, it deprived the government of the instrument of an incomes policy to reduce inflation. All wage agreements were settled well beyond the official inflation target and, except for 1989, pay increases largely exceeded annual inflation. With inflation peaking in 1989 and decelerating only slightly in the following years, even as the business cycle entered its downturn, the government had no other choice than to employ harsh stabilization measures.

### **Fiscal Indiscipline: The Role of Electoral Preferences**

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PSOE (1979)	45	34	(Gunther et al. 1988)
British Labor (1983)	45	25	(Pontusson 1988)
SAP (1979)	66	38	(Esping-Andersen 1985)

<sup>44</sup> A brief but enlightening discussion about how the cabinet understood its relation with trade unions can be found in Maravall 1993: 118-120.

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Independently of how unions behaved, González had strong policy reasons to control and then reduce the public deficit. From a microeconomic point of view, a balanced budget was presented as the best means to build up savings and therefore investment. Similarly, from a macroeconomic perspective, the cabinet believed that, first, a high deficit crowded out investment and that, second, by leaving to monetary policy the task of containing inflation, it pushed interest rates and the costs of capital up. Moreover, the integration of Spain into the European Community, the decision to join the exchange rate mechanism, the progressive liberalization of capital flows -fully completed in February 1992- and the participation in the Maastricht project just added political pressure to the need to control the budget deficit. Still, when domestic demand, the inflation rate and the trade deficit surged in the late eighties, and the government was incapable of containing them through a social pact, fiscal policy gained in importance in sustaining the medium run economic strategy of the PSOE.

*Hacienda* strove stubbornly to reduce the deficit over time. It planned to reduce net lending for the state budget (excluding the Social Security administration) by one point of GDP every year from -4.7 per cent of the projected GDP in 1986 to -0.9 per cent of the potential GDP in 1991. Similarly, it made extensive efforts to keep the Social Security budget in balance. The government's effort met with some success through the late eighties. The general government deficit did decrease from 6.9 per cent of GDP in 1985 to 2.8 per cent of GDP in 1989.

Nonetheless, although some of the decline was due to governmental discretionary efforts, the decline in overall net lending was driven mostly by the spectacular improvement that the Spanish economy experienced in the mid eighties. Except for 1986 and particularly for 1987, fiscal policy was actually expansive. Accordingly, as the pace of economic growth slowed down at the end of

the decade, the lack of real fiscal discipline became apparent and the public deficit crept up again to almost 5 per cent in 1991.

Two factors lay behind the government's inability to contain the budget deficit. On the one hand, territorial governments were running a slightly loose fiscal policy. From 1987 to 1992, the stance of all territorial governments' budgets combined went from 0.0 per cent of GDP to -1.6 per cent of GDP.

On the other hand, the central government eventually caved in to explosive social demands, embodied in the growing mobilization of unions since 1987 and in the electoral erosion suffered in 1986 and 1989.

In general terms, every year *Hacienda* planned to expand the future budget very slightly - mostly in order to accomplish its long-term fiscal plans of reducing the deficit and then translating all savings to physical and human capital formation. Yet at the same time every year actual expenditure did consistently surpass the projected layouts (by around 1 percentage point of GDP). Still, through 1988 all expenditure overruns were comfortably absorbed by unexpected high revenues.

But from 1989 on the rate of increase of revenues, although still strong,<sup>45</sup> did not keep up with the pace of growth of expenditures. Public expenditure grew steadily in 1989 mostly driven by the government-union accords of February 1989. A slight setback in the general parliamentary elections of October 1989, mostly to the benefit of a loose coalition to the left of the PSOE, which put the socialist party one seat below the absolute majority, pressed the González government to expand social expenditure on pensions and unemployment benefits. A sustained push for

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<sup>45</sup> In nominal terms, the annual increases in state revenues were similar every year from 1988 to 1992: they rose 12.5 per cent in 1988, 16.2 per cent in 1989, 14.0 per cent in 1990, 10.0 per cent in 1991 and 9.2 per cent in 1992. Calculations for 1989 and 1990 have been made after adjusting for the withholding of taxes decreed by the government in response to the constitutional sentence in February 1989.

more social spending ended up defeating all plans of fiscal restraint. From 1989 on, the government systematically engaged in the same behavior. Once *Hacienda* eyed, by the end of the first semester, a dramatic acceleration of expenditures, it took harsh measures to align the budget: ad hoc tax increases (all coming in a variety of forms) were imposed every summer; cuts in defense and subsidies and later in capital formation were enforced to accommodate the politically sensitive increases in social policies. Cuts were, however, insufficient. As a result, actual state expenditures jumped from 23.2 per cent of GDP in 1988 (or 0.5 percentage points over the planned budget) to 26.0 per cent of GDP in 1992 (or 2.9 points over the initial budget). The approved level of tax increases was not enough either. The government rejected expanding taxes too strongly: they could easily endanger key middle class sectors essential to maintain the PSOE in power. As a result, the central government budget deficit grew again. After levelling off at 2.0 per cent of GDP in 1989, it rose sharply to 3.3 in two years.

The broadening public deficit of the late eighties had several political implications for González's economic strategy. First, it forced the cabinet to engage in dramatic, unpopular and only mildly successful tightening measures during the course of the fiscal year to salvage its overall budget deficit goals. These cyclical patterns of extraordinary overruns followed by prompt cuts and ad hoc tax increases (all coming in a variety of forms) eroded the government's policy credibility and added indirect costs to the economic climate.<sup>46</sup> Second, it thwarted partially the long run strategy of sustaining public investment - most of the effected cuts to compensate for increased social programs were implemented on capital spending. But, above all, it took away from the socialist government an important tool to reduce inflation and sustain its overall macroeconomic strategy and therefore it pushed the former to rely exclusively on a tight monetary policy to achieve its goals.

## **The Response: A Tight Monetary Policy**

Until well into the economic recovery in the mid eighties, monetary policy played a variable role in the overall economic policy of the González government - tight through 1984 and accommodating in 1985-86 to the framework of the social compact (AES).

After the summer of 1988, monetary policy adopted a definite new course and played a stronger and distinctive role. Economic and political conditions had clearly changed at that time. While inflation was experiencing an upturn, the renewal of the social compact to reduce it looked increasingly unlikely. The public authorities eventually decided to raise intervention rates in early September. In early February of 1989, in the face of continuous inflationary pressures, several measures to curb private credit and foreign capital inflows sent nominal short-term interest rates up to 15 per cent. In real terms the latter were one of the highest in Europe -about 5 percentage points above German interest rates.

Still, the measures taken in February were soon felt to be insufficient. Due to accelerating financial innovations that had boosted liquidity in the Spanish financial market, the traditional system of targeting monetary aggregates had become increasingly uncertain as a means to conduct monetary policy. In addition, the increasing mobility of capitals within the EC was making impossible the conciliation of both a monetary policy directed to reducing inflation and the maintenance of an exchange rate favorable enough to Spanish exports. Cutting

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<sup>46</sup> See Pérez Campanero (1992) and González-Páramo (1992).

through all these dilemmas, the Spanish government decided to integrate the peseta in the European exchange rate system (ERM) in June 1989.<sup>47</sup> Pegging the peseta to the D-mark was believed to strengthen both the credibility of the cabinet's monetary policy and its commitment to fighting inflation, and to further the process of European integration.<sup>48</sup>

To sustain the commitment to an (implicitly) coordinated monetary policy (with the EC) and to decelerate the rhythm of domestic activity, the integration into the ERM was followed by a package of fiscal measures to reduce the deficit and a temporary set of credit controls. Nonetheless, as we have seen above, in spite of successive calls for fiscal discipline, both from within the government and from the Bank of Spain,<sup>49</sup> to sustain the anti-inflationary strategy and to avoid overburdening the monetary policy, the public deficit could not be tamed and, consequently, fiscal policy turned out to add fuel to the expansion of domestic demand. Accordingly, monetary policy was left alone to sustain the disinflationary macroeconomic strategy of the socialist government.

Even in the face of a sharp downturn in economic activity, interest rates would stay at high levels until 1993. Nominal short-term interest rates reached 16 per cent at the end of 1989 and then fell to 15 per cent throughout 1990. In real terms that implied rates of 8 per cent until the end of 1990. Although inflation and interest rates subsequently declined somewhat, that modest downward trend was

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<sup>47</sup> A good analysis of the policy reasoning that led to the integration of Spain in the ERM earlier than was necessary can be seen in Malo de Molina and Pérez (1990). See also the Bank of Spain's *Informe Anual* for 1989 (Banco de España 1989), especially pp. 37 and ff.

<sup>48</sup> Similarly, any depreciation policy through the exchange rate was to be foregone for the sake of price stability since, according to the view of the public authorities, "the costs of joining the EMS would be nominal rather than real because, in an economy like the Spanish one, with a high level of wage indexation, any variation in the nominal exchange rate would quickly be transmitted into prices and the capacity to affect the level of competitiveness and real growth would be transitory." (Banco de España 1989: 39).

<sup>49</sup> See Banco de España 1989: 98 ff.; and Banco de España 1991: 99 ff.

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reversed in 1992. In spite of a declining domestic demand, wage increases and inflation remained high. Then, as the year progressed, a mounting climate of uncertainty over the Maastricht project turned against the ERM. In September 1992 the generalized financial turmoil of European markets put pressure on the peseta. However, the government -for whom the European program of convergence had strong political value- decided to sustain a tight monetary policy. The Bank of Spain intervened massively, temporary foreign exchange controls were again introduced (from mid-September to late November) and the intervention rate was pushed upwards. By the end of 1992, nominal short-term interest rates were over 15 per cent - almost 10 per cent in real terms. As the EMS crisis extended over time and the worldwide economic downturn effectively hit Spain, it was now apparent that the government was increasingly trapped into implementing a very costly economic strategy. Only a prolonged round of devaluations forced by the behavior of the international financial markets and the clear loss of the socialist majority in 1993 would finally compromise monetary discipline and therefore break up the strained equilibrium of political pressures and competing policies that had characterized the González government since the mid eighties.

## **POLITICAL CONSEQUENCES: THE FORTUNES OF THE SOCIALIST ELECTORAL COALITION**

The moderate electoral program developed by Felipe González in the late seventies, the acute economic crisis of the early eighties and the collapse of the center-right governing coalition eventually gave the PSOE the opportunity to capture the political center and to build a broader electoral coalition in the 1982 General Election. The share of the Socialist vote (as a proportion of all the electorate) almost doubled from 20.4 per cent (or 29.9 per cent of the valid vote) in 1979 to 37.7 per cent in 1982 (or 47.3 per cent of the valid vote). Most of the vote

gained in 1982 came from a newly mobilized electorate -both young electors voting for the first time or voters that had abstained in 1979 (around two million voters), a substantial number of former Communist voters that had decided to maximize the chances of a Leftist electoral victory (about one million) and many centrist voters deserting the UCD (over another million) (Puhle 1986). In general terms, the Socialist party was able to draw almost equal support from all social sectors, thereby strengthening its tendency to become something close to a catch-all party.

The nature of socialist support in 1982, as a proportion of all the electorate, is shown in table 4, column 1. Deviations from the national average are minimal in most cases. Only age, urbanization and certain occupational status show significant departures from the mean. While around 50 per cent of the youngest cohort voted for the socialist party, the level of support among the oldest cohort declines to 30 per cent. The distribution of the vote in 1982 clearly shows how the PSOE was successful in mobilizing a broad coalition of the middle and working classes. The level of support for the socialist party among professionals, business owners and middle-level managers fluctuated around 25 per cent - higher than in 1979 yet almost half the percentage won by the PSOE at the national level. The electoral victory in 1982 came to the PSOE by successfully adding white-collar employees in subordinate positions to its natural stronghold - blue-collar workers, particularly in the industry area.<sup>50</sup> When compared to other socialist parties, the occupational structure of the Spanish socialist electorate in the early eighties resembled the social composition of such mainstream socialdemocratic parties as the German SPD or the Italian PSI. It was, however, less oriented towards the

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<sup>50</sup> In 1979 slightly over 20 per cent of white-collar employees (not in managerial positions) and around 34 per cent of industrial workers voted for the PSOE. In 1982, socialist support among the former doubled to more than 40 per cent. Among the latter it also increased -yet not as much in relative terms- to 50 per cent. Hence, the electoral victory of 1982 had mostly come from securing the working class and then reaching to low white collar employees.



working class than the Swedish SAP or the British Labour Party.<sup>51</sup> The same pattern of holding its electoral base and then extending it to voters that had previously supported the UCD can be observed by looking at voters' left-right self-locations. The PSOE doubled its support among extreme leftists (from 17 per cent to 37 per cent) and leftists (from 29 per cent to 55 per cent). More importantly, it turned into the dominant party among those in the center-left, who account for a fourth of the electorate, going from 51 per cent to 75 per cent, and the best supported party in the center with 29 per cent of the vote.

The PSOE expected that moderate socialdemocratic policies -namely, macroeconomic stability, public capital formation policies to accelerate and distribute growth and a generous framework of social benefits- would consolidate the vast coalition stretching from the political center to the traditional left that supported González in 1982. Previous experiences of leftist governments in North European countries made that outcome feasible. Scandinavian socialist parties had secured economic growth, with the assent of the union movement, through a policy mix of macroeconomic stability and microeconomic intervention, and had built an extensive welfare state. Their success had, in turn, cemented a strong alliance between blue-collar and white-collar workers (Martin 1979; Esping-Andersen 1985; Pontusson 1988).

The same result proved somewhat elusive to the González government. On the one hand, although the socialist party consistently led in the polls throughout the eighties, its electoral base suffered a steady erosion over time. On the other hand, its sources of support partly changed - in a direction divergent to what had happened to other socialdemocratic cabinets. Support for the PSOE remained relatively high among traditional blue-collar workers. But it fell sizably among urban middle classes. It instead grew more dependent on voters from rural,

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<sup>51</sup> See Gunther, Sani and Shabad 1986: 197-198. See also data in Esping-Andersen (1985).

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agricultural, underdeveloped areas and on state-dependent populations (such as the unemployed and pensioners).

After gaining the vote of 37.7 per cent of all the electorate in 1982, the aggregate electoral performance of the PSOE worsened quickly. Both the harsh period of adjustment through 1984, which drove unemployment from 17 per cent in 1982 to 21.5 per cent in 1985, and a flip-flopping policy towards NATO, reduced the socialist vote to 30.6 per cent of all the electorate (or 44.4 per cent of valid votes) in the following elections of 1986 - mostly benefiting the radical left and increasing abstention again. The socialist vote would further decline to 27.6 per cent of the electorate (or 39.5 per cent of valid votes) three years later. In 1993, however, after an aggressive campaign that mobilized leftist sectors of the electorate that had tended to abandon the PSOE for the abstention camp (Arango and Díez 1993), support for the PSOE tilted slightly upwards to 29.8 per cent of the electorate. Still, its lead of 17 points over the second party in 1982 had declined to 3 points (see table 2).

**Table 2.** *Share of the Vote in General Elections (1977-1993) as a Proportion of the Electorate*

	Conserv. (AP,PP)	Center (UCD,CDS)	PSOE	Communists	Moderate nationalists (CiU,PNV)
1977	6.3	26.3	22.2	7.0	3.3
1979	4.0	23.5	20.4	7.2	2.8
1982	20.4	7.8	37.7	3.2	4.4
1986	18.0	4.1	30.6	3.2	4.6
1989	17.9	5.5	27.7	6.3	4.3
1993	26.8	1.4	29.8	7.4	4.8

Sources: **Anuario El País** (according to data published by the Junta Electoral Central).

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The structure of the socialist vote changed as well over the decade -directly in response to the set of policies implemented by the González government.

The PSOE's economic and social policies took a clear redistributive bent. The aggressive buildup of capital stock, in the form of ambitious infrastructure projects, was allocated unequally from a territorial point of view. This allowed the socialist cabinet to channel huge amounts of money to finance public investment programs towards the poorest regions. Social policies were expanded significantly after 1988. As a result, social expenditure went up from 25.3 per cent of disposable household income in 1980 to 33.7 per cent of disposable household income ten years later. Contributive pensions were upgraded and to some extent equalized and new categories, such as non contributive pensions, were created. Unemployment benefits were extended to cover more than half the registered unemployed by 1991. Health coverage was improved and expenditure on public education increased more than any other item excluding fixed capital formation.<sup>52</sup> Estimates by Gimeno (1993) show that the allocation of new expenditure was extremely progressive. Public expenditure as a proportion of the average consumption of the lowest income decile went from 119.2 per cent in 1980 to 204.3 per cent in 1990. For the fifth income decile, it went up from 48.4 per cent to 75.1 per cent. For the top income decile it hardly changed: public expenditure represented 31.0 per cent of the average consumption in that income fraction in 1980 and 36.6 per cent ten years later.

Such an expansion in the role of the state logically meant a significant increase in tax collection - mostly implemented through a very progressive

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<sup>52</sup> The increase in social spending had come through higher pensions (3.4 points more as a proportion of total disposable income), unemployment benefits (1.3 points), education (1.8 points) and health (1.8 points) (Bandrés 1993).

personal income tax. Yet, at least in the eyes of the taxpayer, this increase was not matched by good public services.<sup>53</sup> In fact, growing expectations about the public sector and the latter's inability to attend speedily and efficiently to all social demands gave way to widespread disenchantment. Urban and entrepreneurial sectors and regions were more likely to be affected by the unfortunate combination of intense tax pressure and insufficient services. Opinion polls on how Spanish citizens perceive the government's tax and expenditure policies actually uncover important cleavages along these lines. A CIS' survey conducted in July 1991 shows that 56 per cent of all surveyed thought they were paying more in taxes than what they were receiving in public services. That proportion reaches 92 per cent among businessmen and top managers and 69 per cent among mid managerial positions. Among industrial workers it is 56 per cent (i.e. just the national average). Instead, only 40 per cent of retired people and 33 per cent of agricultural workers say that they receive less than they pay. A similar gap appears in relation to income level: 72 per cent of those earning more than Pta. 200,000 say they were receiving less than they were paying; among those earning less than Pta. 50,000 the percentage is only 36 per cent.<sup>54</sup>

Urban and manufacturing sectors were also hit by the internal tensions that beset the government's economic policy. The mix of budget overruns, high interest rates and an overvalued peseta in which the PSOE's economic policy evolved into the late eighties and early nineties had important effects on the economy. The economic climate became increasingly uncertain as a result of the cyclical pattern of strong expenditures in the first semester of each year followed by harsh cuts and new tax increases. High interest rates, necessary to curb

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<sup>53</sup> In 1985 55 per cent of all surveyed thought that the government was wasting part or most of the tax money. In 1992 that proportion had increased to 83 per cent. Data come from Wert, Toharia and López Pintor (1993).

<sup>54</sup> Data come from *Revista Española de Investigaciones Sociológicas*, "Datos de opinión. Los españoles ante el pago de impuestos," (July-September 1991, vol. 55), p. 240.

inflation, sustain the exchange rate and finance the deficit, especially penalized capital-intensive investment (more likely to happen in manufacturing sectors). Finally, the real exchange rate witnessed a strong appreciation after 1982: from mid 1983 to mid 1992 it went up by 44 per cent.<sup>55</sup> The appreciation of the peseta was directly related to the tight anti-inflationary policy engineered by the government in response to strong wage pressures the cabinet could not tame (Bacchetta 1993). That extraordinary revaluation of the peseta, unmatched by similar gains in productivity, was bound to damage, at least in the short run, the competitiveness of the Spanish small and medium firms abroad.<sup>56</sup>

In order to examine the evolution of electoral preferences and the impact of economic and social policies and outcomes of the González government, I engage in two different procedures.<sup>57</sup> First I examine through an aggregate, ecological analysis, the evolution of the socialist vote from 1982 to 1993. Second, I compare the proportion of socialist vote across different social and economic categories.

The ecological analysis clearly points to a significant shift in its composition. Although the level of socialist support has declined in almost all Spanish provinces, the extent of the decline has been rather divergent. In a small number of provinces, support for González has actually increased in ten years, in some cases more than 5 percentage points - as a proportion of all the electorate. At the other end of the scale, in places like Barcelona, Madrid or Valencia, which tend

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<sup>55</sup> Figures consist of the trade-weighted real exchange rate index of the peseta with respect to the industrial countries and based on the consumer price index. After the three devaluations in 1992-93, the peseta fell to its level of June 1989.

<sup>56</sup> A first cut on the economic impact of an overvalued peseta can be found in Gordo and L'Hotellerie (1993), who show that, although Spanish companies did increase somewhat their export share in world markets, their participation in the domestic market diminished substantially in the last decade.

<sup>57</sup> The most appropriate system with which to examine the evolution of the socialist vote would consist of analyzing temporal panel surveys from 1982 to 1993 (that is, surveys of the same individuals for that period of time). Such panels surveys have not been conducted in Spain, however.

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to be populated, heavily urbanized, manufacturing- as well as service-oriented districts, the socialist vote has dropped more than 10 percentage points in absolute terms - or around a quarter of the 1982 vote in relative terms. Table 3 shows how the proportion of urban population, the structure of employment and the volume of public transfers across Spanish provinces have affected the evolution of the Socialist vote. The size of the primary and the tertiary sectors have played a significant role in the unequal fall of socialist support. The percentage of workers in the primary sector, that varies from less than 2 per cent in Madrid and Barcelona to more than 20 per cent in eighteen provinces, explains alone 60.9 per cent of the variation in the change of socialist support (Table 3, column 1). According to this result, within a general framework of decline, each percentage point employed in the primary sector has resulted in an increase of the socialist vote by 0.40 points. Thus, in a province with more than 30 per cent of its active population employed in primary activities, the socialist party would end up receiving in 1993 the same or more votes than eleven years earlier. This striking pattern of electoral behavior is reproduced in Graph 3.

**Table 3.** *An Ecological Analysis of the Change in the Socialist Vote (as a Proportion of All the Electorate) from 1982 to 1993.*

Dependent Variable: Socialist Vote (Over Total Electorate) in 1993 minus Socialist Vote (Over Total Electorate) in 1982.

	(1)	(2)	(3)	(4)	(5)	(6)
Constant	-12.358 <sup>^</sup> (0.931)	16.816 <sup>^</sup> (4.049)	-3.283 (4.762)	-16.026 <sup>^</sup> (1.546)	-7.013 <sup>^</sup> (0.782)	-12.638 <sup>^</sup> (1.010)

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% Employed in Primary Sector	0.403 <sup>^</sup> (0.047)		0.331 <sup>^</sup> (0.059)	0.320 <sup>^</sup> (0.052)		4.436 <sup>^</sup> (0.065)
% Employed in Service Sector		-0.423 <sup>^</sup> (0.076)	-0.149 <sup>^</sup> (0.076)			
%Population Living in Cities under 100,000 inh.				0.071 <sup>^</sup> (0.025)		
Volume of Public Transfers					0.213 <sup>^</sup> (0.054)	-0.004 (0.054)
R <sup>2</sup>	0.609	0.393	0.638	0.668	0.243	0.614
Corr.R <sup>2</sup>	0.601	0.381	0.623	0.653	0.227	0.597
D-W	1.938	1.882	1.847	1.853	2.185	1.900
No of Obs.	50	50	50	50	50	50

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<sup>^</sup> Standard errors in parenthesis.  
<sup>^</sup> Statistically significant at .05 or less.  
<sup>^^</sup> Statistically significant at .10 or less.

Volume of public transfers: Difference between the gross provincial product per capita and disposable family income per capita. Both measures are standardized (i.e. in relation to the national mean) and for 1991. Source: Banco de Bilbao Vizcaya, *Renta Nacional de España y su distribución* (1989).

The weight of the service sector, instead, has accentuated the decline of the socialist support. Column 2 (in table 3) shows that the strength of the service sector alone explains 39.3 per cent of the variation in the evolution of the socialist vote. Both agricultural and service employment are then regressed and the results shown in column 3. The effect of the primary sector appears here slightly tempered by the independent effect of the service economy - each percentage point in the primary sector adds now 0.33 points to the PSOE. Meanwhile each percentage point of service sector employees, whose statistical significance has decreased, explains a drop of 0.15 points in the socialist vote from 1982 to 1993. Industrial employment, alone or in combination with any of the other two categories, has

instead no explanatory power on the evolution of the socialist electorate - the statistical results have not been included here. To sum up, from 1982 to 1993 the socialist vote spread solidly towards rural, agricultural areas; it probably remained stable within the traditional urban, industrial working-class; and then eroded dramatically among the most dynamic, service-oriented sectors of the economy.

As shown in column 4, however, other variables, besides the employment structure of each provincial economy, do affect the evolution of the vote. The proportion of urban population has an independent impact. Even when we control for primary employment, the proportion of population in cities under 100,000 inhabitants shows a statistically significant coefficient.<sup>58</sup>

The shift in the basis of support for González from urban middle-class sectors to rural areas did not appear to depend immediately on the levels of net benefits that each of those sectors might have directly received through state transfers and social expenditures. The volume of social transfers, which is rather divergent across provinces, explains only marginally the change in socialist support over the decade. In columns 5 and 6 we explore the relation between the level of public transfers and the trend in socialist support. Public transfers are here estimated as the difference between the gross provincial product per capita (GPP) and the so-called 'disposable family income' per capita (DFI). The 'disposable family income' is the sum of all wages, capital income, social income (such as pensions, etc.) and net transfers less Social Security contributions and direct taxes. To measure the GPP and the DFI, we use 'standardized' parameters - that is, estimated relative to the national mean (which is 100). For example, in 1991, Girona, enjoying the highest GPP, had a standardized GPP of 140.5, or 40.5

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<sup>58</sup> The proportion of urban population alone explains around 40 per cent of the variance of our dependent variable. The impact of urbanization shows a similar impact when controlled for the size of the service sector - this result is not reproduced here.



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per cent higher than the national mean, whereas Badajoz, with the lowest one, showed a standardized GPP of 56.7. The difference between GPP and DFI is assumed to show the net level of transfers from the state - that is, how taxes and social expenditure affect final income and correct for strong initial inequalities. As a matter of fact, this parameter fulfills its goal rather crudely. It measures neither the levels of public fixed capital formation and public employment nor the impact that the latter may have on the growth rate of each area. Thus it should only be taken as a tentative step towards examining the electoral impact of public policies. Regressing our parameter on state transfers produces a significant estimate from a statistical point of view. However, once we control for other variables, such as employment in the primary sector (column 6), all its significance wanes (see also graph 4).

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Table 4 presents a second cut on the evolution of the socialist vote during the eighties: it reproduces the proportion of the electorate that voted PSOE and the conservative party (AP, later PP) in 1982 and 1993 according to different social features. The balanced pattern of support for the PSOE in 1982 had given way to a more fragmented, polarized vote eleven years later. In 1982 the level of support for the PSOE across social sectors never fell below four fifths of the national average. The only exceptions could be found among the oldest age cohort (where the socialist vote was 30.1 per cent, or three quarters of the national vote for the PSOE), university-educated voters, non-salaried jobs (where the socialist vote was less than two thirds the average in other groups) and practicing Catholics. In 1993, instead, the disparity in electoral behavior had widened. Among the highest educational levels, support for the socialist party, at around 18 per cent, was almost half the national average. Most notably, the socialist vote was a third of the national average among professionals and a half among both top managers and white-collar employees. Instead, it was forty per cent higher than the average among industrial and agricultural workers.

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**Table 4.** *Proportion of Socialist and Conservative Vote in 1982 and in 1993 According to Social Conditions.*

	In 1982		In 1983	
	Per cent voting PSOE	Per cent voting AP	Per cent voting PSOE	Per cent voting PP
<b>Age</b>				
18-24	50	13	23	20
25-34	44	13	28	18
35-44	40	12	33	21
45-54	34	11	30	25
55-64	33	12	37	24
65 or more	30	12	36	18
<b>Educational Level</b>				
Less than primary schooling	38	13	35	19
Primary schooling	40	12	31	20
High school	44	12	22	22
Less than university	31	12	19	34
University	30	12	18	32
<b>Level of urbanization</b>				
Less than 2,000 inh.	39	16	35	24
2,001 to 10,000 inh.	32	12	29	25
10,001 to 50,000 inh.	39	10	35	15
50,001 to 100,000 inh.	41	18	35	16
100,001 to 400,000 inh.	39	14	28	23
400,001 to 1,000,000 inh.	37	11	23	25
More than 1,000,000 inh.	44	10	30	19
<b>Working Status</b>				
Active Pop.	42	13	29	24
Not Active				
Students	39	6	18	25
Unemployed	55	11	33	
* lost job	n.a.	n.a.	35	14
* searching for first time	n.a.	n.a.	18	18
Retired	39	12	37	
* working before	n.a.	n.a.	41	17
* houseold occ. before	n.a.	n.a.	25	23
Household occupation	32	12	34	19

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## Occupational Status

(1) Non salaried:

Professionals	24	21	12	44
Business owners with employees	28	28	22	38
Business own. without employees				
* in industry and services	24	23	24	25
* in agriculture	26	17	29	28

(2) Salaried. White-collar.

Top managers	36	11	14	34
Mid-level managers	24	22	22	28
White-collar employees (clerks,etc.)	42	11	17	30
Salesman	44	11	27	17
Low nonmanual employees	35	14	27	18

(3) Salaried. Blue-collar.

Foremen, supervisors	55	14	25	25
Workers in industry and services			40	12
* skilled	49	7	n.a.	n.a.
* unskilled	45	7	n.a.	n.a.
Workers in agriculture	41	6	43	11
* with fixed contracts	n.a.	n.a.	34	
* with temporary contracts	n.a.	n.a.	46	

## Religiosity

Practising catholic	29	18	27	33
Non-practising catholic	50	8	37	15
Indifferent/non-believer	51	3	26	6
Other religions	50	0	24	16

## Left-right scale<sup>1</sup>

Far Left	1	37	1	40	1
	2	44	0	38	2
Left	3	60	0	54	1
	4	60	2	62	4
Center-left	5	40	9	27	21
Center-right	6	13	37	13	47
	7	4	51	3	64
Right	8	6	57	4	75
	9	1	60	4	92
Far right	10	6	47	0	68

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Total vote according to sample	39	12	31	21
Annual Total vote	38	20	30	27
Difference between actual and reported vote	+1	-8	+1	-6

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All data as proportions of all surveyed (no responses included).

Sources. Own estimations based on:

CIS survey no. 1327 (post-electoral survey) for the 1982 General Election.

CIS survey no. 2062 (June 1993, monthly 'barometer') for the 1993 General Election.

<sup>1</sup> Data for 1982 taken from Gunther (1986), table 2.1, p. 46.

Support had become fragmented and strongly divergent. The PSOE clung successfully to its natural stronghold: 40 per cent of the workers in the industry and service sectors voted for González in 1993, somewhat less than eleven years before but still well over the national average. Among agricultural workers, the socialist party indeed increased from 41 per cent in 1982 to 43 per cent - within this group the PSOE obtained a huge lead among temporary workers.<sup>59</sup> The PSOE secured significant support among welfare recipients - who have been directly favored by the expansion of resources in social policies in the late eighties. The vote remained stable among retired people who had held a job before. Although the unemployed had abandoned González in huge numbers, those who had held a job previously (and were likely to receive unemployment benefits) were still trusting the socialist government - 35 per cent voted PSOE in 1993 (another 12 per cent voted for the radical Left, IU). A very different pattern appears among those

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<sup>59</sup> The socialist vote only increased among salaried agricultural workers and independent farmers without employees.

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unemployed searching for jobs for the first time (and thus unable to get unemployment benefits) - only 18 per cent voted PSOE in 1993 (but here only 4 per cent voted for IU).

White-collar employees, instead, deserted the socialist party. Less than half of the top managers and white-collar employees proper voted again for the socialist party. The erosion of socialist support was also substantial among the blue-collar elite of foremen and supervisors - 55 per cent voted for González in 1982 but only 25 per cent did so in 1993.

In terms of the ideological self-location of the voter, the PSOE was able to maintain its support within the left (around 40 per cent within the far left and 60 per cent among the left). But, more significantly, among center-left voters (those in position 5 in the left-right scale from 1 to 10), which represented the largest segment in the Spanish electorate (around a fifth of all those surveyed), support for the socialist party had declined from 40 per cent to 27 per cent.

In short, almost eleven years after González was elected, a consistent pattern of redistributive social and economic policies both trimmed and skewed the support of the socialist party. The expansion of the welfare state and the active role of the state in building infrastructures and providing services strengthened the position of the socialist party in the most underdeveloped areas, among the less favored sectors (such as those with low levels of education) and among the most dependent on public transfers (the unemployed and the retired). Instead, high taxes, unfulfilled expectations about the level and quality of services and harsh macroeconomic policies (particularly regarding interest rates and the exchange rate) eroded the socialist support in urban areas, among the most educated and probably in the most competitive, export-oriented areas.



## CONCLUSIONS

In 1982 the Spanish socialist party was elected to office with an impressive parliamentary majority. Acknowledging strong financial and international constraints, the González cabinet shunned demand-led expansionary policies and increasingly committed itself to a program of macroeconomic stability. The Spanish socialist government did not reject, however, to use of the public sector to enhance the competitiveness of the Spanish economy. Tax revenues were increased steadily. A remarkable effort was made to increase the level of public (and hence, total) savings. Vast resources were directed to improve the Spanish physical and human capital stock. At the heart of these decisions lay the notion that only a strategy focused on enhancing the Spanish economy's productivity could reduce the level of unemployment, increase income levels and equalize social conditions. Only policies geared towards adding value to Spanish products could at the same time make them competitive enough in the world market and allow real wages to increase over time. With rising productivity, more resources could be then found to finance social transfers. As a matter of fact, supply-side economic policies of that kind have always constituted the core element of all socialdemocratic strategies.<sup>60</sup>

The González government encountered, however, several insurmountable obstacles. As in Britain in the seventies, it could not subject inflation through union assent. Completely deregulating the labor market and abolishing minimum wages (to make workers responsive to market forces) was, however, out of the question. The distribution of electoral preferences unsettled as well the government project. It had to accommodate aggressive social demands not to lose its left-wing voters. Yet excessive tax increases started to unnerve key middle class supporters. As a result, public deficits ballooned - in fact upsetting both the

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<sup>60</sup> For a longer, more detailed exposition of this idea, see Boix (1995).

demand and the supply dimensions of the government's strategy. Hence the government had to ride on a tight and electorally damaging monetary policy.

When looked at in broad terms, the Spanish experience indicates that in order to sustain a socialdemocratic supply-side strategy any socialist party faces now -in increasingly open economies in which traditionally encompassing and unified labor movements are disappearing- two options. On the one hand, it may want to turn unions into reliable social partners (as in Scandinavia), through a process of institutional engineering. It seems unclear, however, how this option, which would be enormously difficult to put in practice, can help to raise Spanish productivity.

On the other hand, a socialist government may want instead to restore a balanced budget first and to deepen then its commitment to a high value-added competitive strategy based on massive public spending to turn most of the population into a skilled labor force. This could be accompanied with a truly 'deregulated' labor market that would provide for the necessary flexibility to compete abroad, lure businesses to invest and therefore reduce unemployment.<sup>61</sup> There are, however, several obstacles to this strategy as well. With a relatively unskilled workforce, Spain starts in a rather disadvantageous position within the OECD. It is only in the long run that a strategy to create a skilled workforce may have any substantial impact on the unemployment rate. Accordingly, it might be difficult to sustain an electoral strategy on policies and promises that will clearly bear fruit only in the distant future. Only a well organized party capable of fully mobilizing its constituencies (and helped by a divided opposition) can sustain a decided public investment strategy (at the expense of present public consumption) over time, that is, without losing electoral support. This condition is not met by the Spanish socialist party today. It was probably the lack of a strong party

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<sup>61</sup> With a highly qualified population a deregulated market would not necessarily mean low wages, higher pay differentials, and increased inequality.

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organization that jeopardized the PSOE's commitment towards a balanced budget and strong public capital formation policies in the late eighties. In fact, as a result of the electoral changes surveyed in the last section of this paper, it would be even harder for the PSOE to engage in interventionist supply-side policies. Most of the social groups that supported the PSOE in 1993 (as well as a good part of the existing political cliques within the party) would gain little from these supply-side policies in the medium run.

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