**Eurozone Crisis: The Spanish Ulcer and Monsieur Hollande’s Holiday**

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¡No Pasarán! Spain slides back into recession. montrealgazette.com

Even as Rafael Nadal gracefully accepted his cheque for €300,000 for winning the Barcelona tennis championship for a seventh time, the Spanish economy relapsed into recession.

In response, markets savaged the IBEX stock index, while ratings agency [Standard & Poors last Thursday downgraded the credit rating of 16 Spanish banks](http://www.reuters.com/article/2012/04/30/markets-ratings-spanish-banks-idUSWNA612620120430) to BBB+/A-2.

For the second time since 2009, Spain recorded negative growth. On this occasion, [the economy shrank 0.3%](http://money.cnn.com/2012/04/30/news/economy/spain-recession/) in the March quarter, hard on the heels of last week’s news of Britain’s double-dip recession.

Given the Madrid government’s parlous finances, they might want a piece of Nadal’s cake, as the [Spanish tax office launched an investigation of Nadal’s companies](http://www.examiner.com/article/tennis-plus-taxes-equals-trouble) in the Basque region in February.

Spain’s austerity measures have produced almost 25% unemployment, although the large number people working in the informal economy exaggerates these figures somewhat. The Spanish finance ministry estimates that the 365,000 lost jobs in March quarter means almost €1 billion in lost tax revenues for Mariano Rajoy’s government.



The price of failure: 25% unemployment. businessinsider.com

These unemployment figures put Espana squarely back in 1985. Right before Madrid joined the European Union, to be precise. Back then, Spanish living standards were around 62% of the EU average.

**The Spanish Apartment**

Why did the Spanish economy collapse following the global financial crisis? One reason is the popping of the property bubble: between 2007 and 2011, property prices officially fell 17%, but some regions saw price collapses of up to 50%. Parts of Spain now look suspiciously like Ireland: hundreds of thousands of apartments and houses stand derelict, literally abandoned by their bankrupt developers.

So, superannuated Brits (if there are any left) and cashed-up Australians can pick up potential bargains, although Spanish banks aren’t too keen to lend on property.

Moreover, the Spanish government has scrapped the tax incentives that prodded people to invest in property.

**¿Qué Pasa**

Let’s get Real, Madrid: when Spain joined the EU in 1986, it sold off its manufacturing industries – mostly to the Germans – lock, stock and barrel.

That left property and tourism to fuel Spain’s largely services-oriented economy. Sure, there are major, majority-Spanish-owned energy players like Repsol, and some enviable green-tech exporters, but Spain is horribly vulnerable to regional and global financial shocks. Adoption of the euro from 1999, which replaced the weak peseta, meant Spanish multinationals spread their wings worldwide, investing in Latin America in particular.

But this also meant that Spanish business didn’t invest in Spain. Yes, *Spain is a net exporter of investment*(and let’s not get started on how [Argentina is rapidly nationalizing Spanish-owned assets](http://www.nytimes.com/2012/04/21/business/global/spain-stings-argentina-over-nationalization-of-repsol-ypf.html)). Its largest source of FDI is France (over 40%), although this largely comprises French firms funnelling resources into their Spanish subsidiaries. The UK is the second-largest investor in Spain, although property and investment incentives have driven British cash to Spain

**The rain in Spain turns quickly into pain**

Property investment and home ownership is just great – when it’s bubbling. But it’s also dead capital subsidized by government tax incentives (much like negative gearing in Australia). As [The Economist reported in 2011,](http://www.economist.com/node/18285595) Spain emerged as one of the most overvalued property markets in the world by 2011.

Four years ago, many Spaniards were considering a second (holiday) home. Now, some are wondering whether they will soon be homeless – if they aren’t already.

**Meanwhile, in Gay Paree…**

Super Sarko, aka President Nicolas Sarkozy, is just days away from having his swashbuckling career cut short.

His opponent, the bookish Socialist, François Hollande, appears too far ahead – 10%, according to some polls, 6% in others – for Sarkozy to catch him, even if the President’s Union pour un Mouvement Populaire (UMP) party were to obtain most of the support gained by the Front National’s Marine Le Pen in the first round.

Now Hollande’s prospective election poses new challenges for the beleaguered Eurozone. German Chancellor Angela Merkel hasn’t even bothered awaiting the French election result, deriding Hollande’s calls to renegotiate the fiscal compact crafted by Sarkozy and Merkel in 2011–12, and formalized in March this year.

Hollande may talk tough, but his options are limited, as the more disciplined fiscal regime implemented under the Berlin-Paris axis since March 2012 is now carved in hard EU law (even if Ireland knocks the compact back, the EU will simply proceed without Dublin).

Hollande wants to spend his way out of trouble, and this would involve mutualizing Eurozone debt by employing the (theoretically unlimited) resources of the European Central Bank and issuing EU-backed debt bonds (not to be confused with ‘eurobonds’ which have been around since 1960).

Hollande does hold one ace in his hand: if the Socialist Party (PS) wins a parliamentary majority, as well as the keys to the Elysée Palace, then the PS can block ratification of the Eurozone compact, until Hollande extracts some compromises from Berlin.

The PS’s official platform is to renegotiate the fiscal compact, but the realities of office, the resolution of Merkel (who declared reopening debate on the matter “futile”), combined with the Bundesbank’s refusal to countenance anything but austerity measures to rein in Europe’s chronic deficits.

A Holland victory would see the Socialists in the Elysée for only the second time since World War II. In 1981, François Mitterrand won an historic victory in coalition with the Communist Party, which resulted in a series of disastrous nationalizations, followed by a dramatic *volte-face* in 1983. Mitterrand abandoned nationalization and, ultimately, turned to deregulation and privatization, championed largely by his Gaullist Prime Minister (and future president), Jacques Chirac.

France and Hollande no longer have these policy options on the table. France and Germany have run the EU for so long, a fracturing of the relationship would have dire consequences for Eurozone policy. But Hollande has some unlikely allies in the Netherlands and ECB President Mario Draghi, who has called for a ‘growth pact’ to offset the austerity measures.

For Merkel, ‘growth pacts’ are code for financial indiscipline and fiscal laxity. But Europeans have tried austerity for four years; the votes are in, and they don’t like the results.

Frankly, Europeans can vote out every conservative/centrist/socialist government they like and replace them with the opposition, but it won’t make a jot of difference to either the EU’s financial instability or fiscal austerity.

If you believe David Cameron, Europeans are [only half-way through the Eurozone crisis.](http://uk.reuters.com/article/2012/04/29/uk-britain-cameron-eurozone-idUKBRE83S0AD20120429) Politicians better buckle up: there are many more winters of voter discontent to come. As wise old Rene Descartes was wont to say, “it is a mark of prudence never to place our complete trust in those who have deceived us even once.”