4. Financialisation and the economic crisis in Spain

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4.1 INTRODUCTION

The aim of this chapter is to analyse the relationship between the financial crisis and the real economic crisis in Spain. The main hypothesis put forward by this chapter is that financialisation, which lies at the root of the financial crisis, has also implied changes in the real and financial behaviour of private (and public) agents, which explain the extent and prolonged duration of the crisis in European and other advanced economies, in general, and in Spain in particular.

With this aim in mind, we will first analyse the financialisation process of the Spanish economy, and then its effects on households, non-financial corporations, and the external sector. Finally, we will focus on the mistakes in the management of fiscal policy and in the management of the Spanish banking crisis that have helped to deepen the economic crisis.

4.2 THE FINANCIALISATION PROCESS OF THE SPANISH ECONOMY

Like most developed countries, the Spanish economy has financialised intensely in recent decades (Altuzarra et al. 2013). When we take the size of the financial sector as a percentage of GDP as a proxy for financialisation (Sawyer 2014), we see that it is a quite recent phenomenon in Spain, starting in the nineties, that is, later than in other European and advanced economies: between 1980 and 1990 outstanding financial liabilities in Spain increased from 222 per cent to 325 per cent of GDP, but they amounted to 647 per cent of GDP in 2002, and they peaked at 1,006 per cent of GDP in 2012. Although financial assets and liabilities have both grown in a sustained way, the growth of the financial liabilities has been much faster than that of assets. As a result, the net debit balance against the rest of the world has been increasing since the eighties. Thus, net financial assets of the Spanish economy have moved from −9.9 per cent of GDP in 1990 to −31.6 per cent of GDP in 2000 and to −95.5 per cent of GDP in 2013.

This excessive indebtedness is one of the key elements that explain the extent of the economic crisis in Spain. The financial turbulence that has affected the world economy after 2007 led to severe constraints in access to the international financial markets for all economic sectors, but mainly for the banking sector. These problems were exacerbated by the sovereign debt crisis in the Euro area and its contagion effects. Furthermore, the excessive indebtedness of private non-financial (non-financial corporations and households) agents forced an intense deleveraging process that has negatively affected economic activity, at least until 2013.

The increase in the financial liabilities in Spain can be explained entirely by the larger debt incurred by private agents, which in 2007 amounted to 886 per cent of GDP. All private agents saw an increase in their financial liabilities: between 1997 and 2007 the financial liabilities of households rose from 43 per cent to 89 per cent of GDP; while those of non-financial corporations changed from 191 per cent to 386 per cent of GDP, and those of financial institutions rose from 246 per cent to 411 per cent of GDP. Conversely, the general government's financial liabilities fell from 79 per cent in 1998 to 48 per cent of GDP in 2007.

The economic crisis, which, in Spain, started at the end of the year 2008, marked a turning point in the financialisation of the Spanish economy. Non-financial corporations and households have deleveraged intensely, and in 2013 their outstanding financial liabilities (339 per cent and 83 per cent of GDP, respectively) were lower than those seen in 2007. In the case of financial institutions, their financial liabilities went on rising until 2012 (480 per cent of GDP), but in 2013 a sudden adjustment of the liabilities of the financial system took place, and its financial liabilities fell to 433 per cent of GDP.

Given that this deleveraging process has taken place within the context of a major economic crisis (Spanish GDP at current prices in 2013 was 6 per cent lower than in 2008), the above figures underestimate the process of nominal deleveraging that has taken place in Spain since the onset of the crisis: between 2007 and 2013 non-financial corporations reduced their financial liabilities by 598 billion euros (−14.7 per cent). In the case of the household sector, financial liabilities fell by 90 billion euros (−9.6 per cent). If we focus on financial institutions, their financial liabilities increased to 98 billion euros (+2.3 per cent), but the deleveraging process of the financial sector started later than for other sectors: thus, only in the year 2013, financial institutions diminished their financial liabilities by 519 billion euros (−10.5 per cent).

4.3 ECONOMIC ACTIVITY IN THE FINANCIALISATION ERA

The Spanish economy has gone through three different phases since 1980. In the first phase (1981 to 1993) Spain enjoyed noticeable economic growth. This phase ended abruptly with the crisis of the European Monetary System. The most intense and lasting phase of growth of recent decades commenced after 1993. This second phase came to an end in 2007. In 2008 the current phase of recession and economic stagnation began (lasting until 2013), which meant that real GDP in 2013 was 6.7 per cent lower than in 2008.

During these four decades, the composition of Spanish GDP has undergone a deep change. Although final consumption of households amounted to 60.7 per cent of GDP in 1980 (GDP measured at chain-linked volumes, reference year 2005), since the mid-eighties it remained quite stable, at around 57 per cent of GDP. This situation changed with the current crisis, and household consumption commenced a downward trend after 2011, falling to 55.3 per cent of GDP in 2013.

Conversely to household consumption, final consumption of the general government (public consumption) has gained relevance. During the first phase, public consumption increased very quickly, from 13.1 per cent of GDP in 1980 to 17.6 per cent of GDP in 1993. After this year, public consumption declined, reaching 16.5 per cent of GDP in 1999. Although public consumption returned to an upward tendency in 2000, public consumption gained a new impulse in the 2006–2008 period, rising from 18 to 19.3 per cent of GDP. With the crisis, public consumption kept on rising, peaking at 21.2 per cent of GDP, but the fiscal austerity measures implemented since 2010 have made public consumption fall to 20.2 per cent of GDP in 2013.

Gross capital formation (GCF) has been the component of GDP that has gained the most weight. Although GCF fell in the early eighties, both as a percentage of GDP (from 22.4 per cent of GDP in 1980 to 18.9 per cent of GDP in 1984) and in absolute (real) terms, GCF started to rise after 1985, and since then it has always been above 20 per cent of GDP. Indeed, GCF rose from 22.7 per cent to 30.9 per cent of GDP between 1993 and 2007. This tendency dramatically changed with the current crisis: in 2013 GCF only amounted to 20.5 per cent of GDP.

The depth of the structural change of the Spanish economy was more clearly reflected in the evolution of the size of the trade flows. Spain's trade openness rose between 1980 and 2013 from 18.8 per cent to 62.5 per cent of GDP. During this period a negative sign on net exports of goods and services has prevailed, with an annual average balance of goods and services amounting to −1.7 per cent of GDP. However, the trade balance is highly cyclical: the phases of expansion have always gone hand in hand with high external trade deficits, which are corrected during the downward phases of the business cycle. This pattern has also taken place in the current stage of recession and economic stagnation. Thus, in 2013 the balance of goods and services reached an unparalleled surplus of 2.4 per cent of GDP.

Although the current improvement in the trade balance could be (partially) explained by the poor economic situation and its consequent (declining) impact on imports of goods and services, in contrast to previous crises the goods and services surplus is nowadays driven by higher exports and not (so much) by lower imports. Between 2007 and 2013, the balance of goods and services moved from a deficit of 6.7 per cent of GDP to a surplus of 2.4 per cent of GDP due to lower imports (−1.9 per cent of GDP) and higher exports (+7.2 per cent of GDP). The export-led improvement in the trade balance is more evident if we focus on the period 2010–2013: the trade balance has moved from −2.1 per cent of GDP to +2.4 per cent of GDP thanks to higher exports (+6.7 per cent of GDP). Therefore, exports have been the main driving force of the Spanish economy in more recent years, avoiding an even greater decline of the economic activity. As far as this rising trend in exports being maintained, this could involve a change in the model of growth of the Spanish economy, less dependent on domestic demand, in general, and private consumption, in particular.

In order to explain the model of economic growth in Spain during the last decades it is useful to analyse the contribution of the main components of the aggregate demand to real economic growth. During the first period, from 1981 to 1993, the average annual GDP growth rate was 2.5 per cent. In this period we cannot find a clear-cut growth model, because both at the beginning (1981) and at the end (1993) of the period economic growth was negative. Therefore, the period reflects a business cycle, which includes a first period with an upward trend that began with negative growth, a plateau, where high rates of growth (above 2 per cent) were recorded, and, finally, a downward trend that began in 1992 and ended in 1993 with a negative growth.

At the beginning (1981–1984) and the end (1992–1993) of the period, external demand contributed positively to economic growth due to the decline of imports, which helped to improve the balance of goods and services. Conversely, in the intermediate years (1985–1991), the contribution of external demand to economic growth was negative, due to the weak growth of exports of goods and services and, mainly, the strong growth of imports.

Regarding the components of domestic demand, we can highlight the role played by public consumption and gross capital formation as the driving forces behind growth. As an average for the whole period, the contributions of public consumption and GCF to the GDP growth rate amounted to 0.7 and 0.6 per cent, respectively. Although the largest absolute contribution to GDP growth came from private consumption (1.2 p.p.), this is because private consumption is the biggest component of GDP. Between 1981 and 1993, household consumption actually fell from 60.1 per cent to 58.2 per cent of GDP.

In sum, in this first period, the growth model of the Spanish economy was based on higher domestic demand, where the driving forces of economic growth were public consumption and gross capital formation.

The second phase (1994–2007) was characterised by a high and sustained growth, with the average growth rate of GDP amounting to 3.7 per cent. Domestic demand was again the driving force behind the Spanish economy, with a contribution to GDP growth amounting to 4.4 p.p. Conversely, external demand increased its negative contribution (−0.7 p.p.): although exports of goods and services rose from 16.1 per cent to 27.1 per cent of GDP, with a contribution to economic growth amounting to 1.7 p.p., imports of goods and services saw an extraordinary increase, from 15.9 per cent to 34.2 per cent of GDP. As a result, the balance of goods and services moved from +1 per cent of GDP to −6.8 per cent of GDP.

If we focus on the components of domestic demand, the driving forces in this period were household consumption and gross capital formation. The contribution of public consumption to economic growth (0.7 p.p.) was similar to that of the previous phase. Nonetheless, it is important to note that although until 1999 the size of public consumption had declined, after 1999 it started to rise, reaching 18.4 per cent of GDP in 2007, above the level seen in 1994 (17.3 per cent of GDP). The contribution of household consumption to economic growth in this period amounted to 2.1 per cent. Thus, the growth of private consumption enabled its size to remain unchanged as a percentage of GDP during these years. Gross capital formation was the component with the highest rise. Its contribution to GDP growth amounted to 1.6 per cent. This strong growth of GCF implied that its size rose from 22.7 per cent of GDP in 1993 to 30.9 per cent of GDP in 2007.

In sum, the growth model of the Spanish economy in this phase (1993–2007) was domestic-demand driven, with the main driving forces of economic growth coming from household consumption and, mainly, gross capital formation.

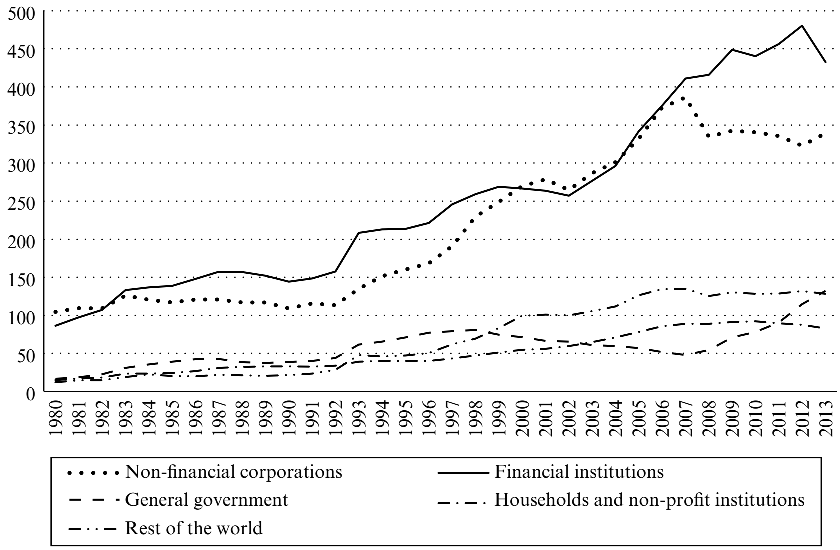
The current financial and economic crisis has led to a radical change in the Spanish economy. Between 2008 and 2013, the average GDP rate of growth was −1 per cent. This collapse in economic activity is entirely explained by the collapse of domestic demand, whose contribution to GDP growth was −2.8 per cent, and, as a result, the size of domestic demand has fallen between 2007 and 2013 from 107 per cent to 96.1 per cent of GDP. Conversely, during the crisis the contribution of external demand to economic growth has been positive (+1.8 per cent). The external sector has become the only driving force behind the Spanish economy during the current crisis. Both exports and imports of goods and services have contributed positively to economic growth (+0.7 per cent and +1.1 per cent, respectively): between 2007 and 2013 exports rose from 27.1 per cent to 33.1 per cent of GDP, and imports fell from 34.2 per cent to 29.5 per cent of GDP.

Since 2008, until 2013, both household consumption and gross capital formation have negatively contributed to economic growth: −1 per cent and −2 per cent, respectively. Regarding public consumption, its contribution to GDP growth was limited but positive (+0.1 per cent), a proof of the stabilising role played by the public sector in the crisis.

However, when we analyse the behaviour of domestic demand since 2008 we can detect the existence of two sub-periods: 2008–2010 and 2011–2013. Although average GDP growth rates in these periods were similar (−1 per cent and −0.9 per cent, respectively), the contributions of the components of domestic demand to economic growth significantly changed: contributions in these periods of household consumption were −0.8 per cent and −1.1 per cent; contributions of public consumption were +0.7 per cent and −0.5 per cent; and, lastly, those of GCF were −2.6 per cent and −1.3 per cent.

Therefore, the main decline in investment took place at the beginning of the crisis, that is, before 2011, contrary to what happened to household consumption, whose deterioration accelerated after 2011. Lastly, in the case of public consumption, fiscal austerity measures implemented since 2010 have turned the contribution of this component to economic growth negative, thus aggravating the economic recession.

Figures 4.1, 4.2 and 4.3 show the financial balance sheets of the different economic sectors. The study of the financial balances, joined to the analysis of the contributions of the different components of aggregate demand to economic growth will help us to identify the type of long-run development of the Spanish economy: debt-led consumption, domestic demand-led, weak export-led or export-led mercantilism (Hein 2012). Again, we will analyse the type of long-run development for the three phases of growth previously defined: 1980–1993, 1994–2007 and 2008–2013.



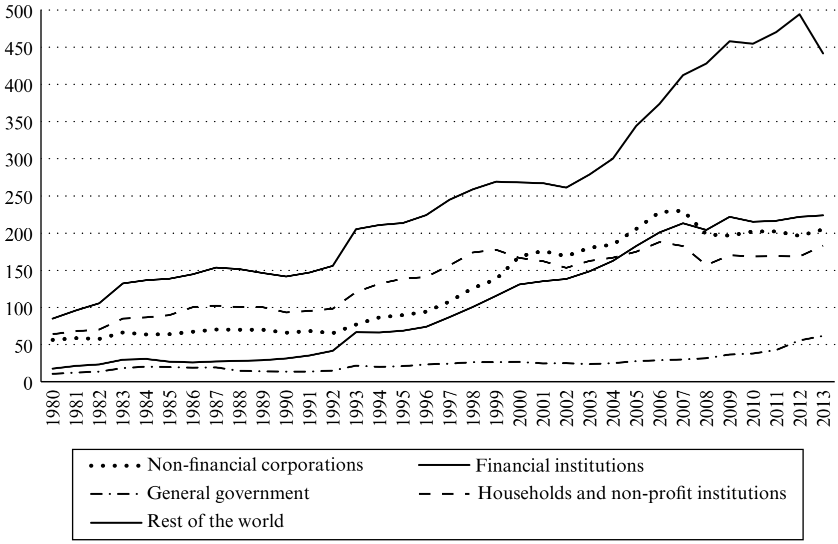
Source: Our calculations based on Bank of Spain, Boletín Estadístico, Financial Accounts of the Spanish Economy, Financial Accounts.

Figure 4.1 Financial liabilities (per cent of GDP)

During the period 1980–1993, the financial balance of non-financial corporations was very stable, with only small changes in the size of their financial liabilities and assets. In the case of financial institutions, the most relevant fact is that, after 1992, they maintained a low and stable annual growth of their financial assets and liabilities close to 5 per cent of GDP.

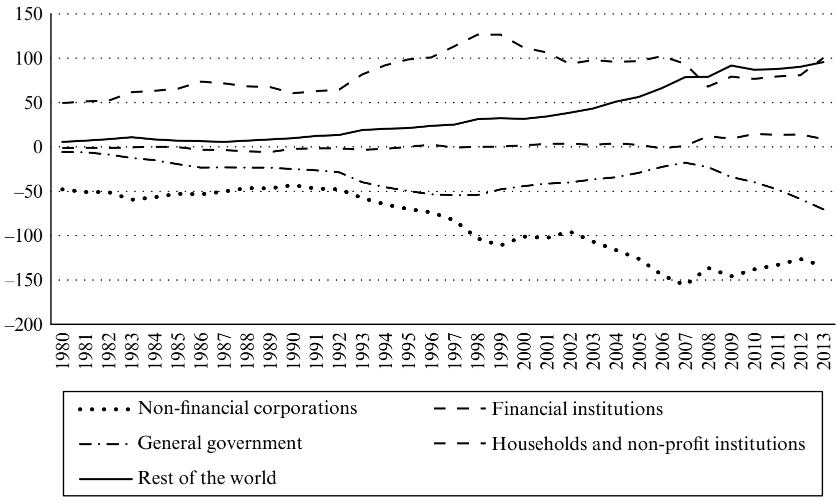
The behaviour of the general government's financial balance is closely related to the business cycle and the public budget balance. The stability of financial assets, at least until the current crisis, made financial liabilities become the most volatile component of financial balance, thus being the main determinant of the variations in net financial assets. In this first phase, the high fiscal deficits of the early eighties explain the increase in the outstanding general government's financial liabilities. The adjustment of fiscal imbalances that took place after the mid-eighties meant that the size of financial liabilities and net financial assets remained stable until the crisis in 1993.

Spanish households saw an increase in the size of their balance sheet, although the higher increase of the assets led to a higher size in net financial assets of households. This process ended abruptly in the late eighties, at the same time as a strong increase of household consumption. In this



Source: Our calculations based on Bank of Spain, Boletín Estadístico, Financial Accounts of the Spanish Economy, Financial Accounts.

Figure 4.2 Financial assets (per cent of GDP)



Source: Our calculations based on Bank of Spain, Boletín Estadístico, Financial Accounts of the Spanish Economy, Financial Accounts.

Figure 4.3 Net financial assets (per cent of GDP) period, household financial assets fell slightly at the same time as their liabilities rose. The result was a fall in household net financial assets, which only recovered in 1993 due to the major increase in financial assets.

In the case of the external sector, its financial balance was positive, with a very small current account deficit. Nonetheless, the acceleration of economic growth and the increase in the trade deficit mentioned above led to an increase in the positive financial balance of the external sector.

Therefore, the type of development of the Spanish economy in this first period might be referred to as a domestic demand-led type, given the existence of a positive financial balance of the household sector and a negative contribution of the external sector to economic growth.

During the second phase (1994–2007), non-financial corporations saw a considerable increase of financial assets and liabilities, although the greater increase in the latter led to a strong decline of their financial balance, which fell from −57.7 per cent of GDP in 1993 to −155.9 per cent of GDP in 2007.

In the case of financial institutions, the most relevant fact is related to the evolution of the size of their financial balance. With financial liabilities taken as a proxy, the size of the financial balance of the sector rose from 205 per cent of GDP in 2003 to 412 per cent of GDP in 2007. This financial expansion accelerated after 2003: between 1993 and 2002 the size of the financial balance of financial institutions increased annually by 5.6 p.p. of GDP, but between 2003 and 2007 this growth increased by up to 26.7 p.p. of GDP.

During this second phase, households' financial assets saw a significant increase. However, between 1999 and 2002 they fell 24 p.p. of GDP. Later, the size of financial assets increased again, although it fell by 5.1 p.p. of GDP in 2007. Financial liabilities grew in a sustained manner, accelerating between 1996 and 2006, when they moved from 40.1 per cent to 85.6 per cent of GDP. Resulting from larger liabilities, net financial assets, which peaked at 126.6 per cent of GDP in 1998, began a decline, falling to 93.7 per cent of GDP in 2007.

Regarding the general government, the growth of its financial liabilities remained positive until 1998, when their size reached 80.7 per cent of GDP. Since then, the improvement in public finances led to a fall in the outstanding financial liabilities to 48 per cent of GDP in 2007. Thus, the general government's negative financial balance fell from −54.7 per cent to −17.8 per cent of GDP between 1997 and 2007.

Lastly, in the case of the financial balance of external sector, since 1996, but mainly since the year 2000, the positive financial balance of this sector increased significantly (from 19 per cent of GDP in 1993 to 78.7 per cent of GDP in 2007) as a consequence of the rising current account deficits.

The type of long-run development in this second phase is more ambiguous. The high contribution of domestic demand to economic growth, both of private consumption and investment, and the negative contribution of the external sector point to a domestic demand-led growth, given the positive financial balance of households. However, the deterioration of households' financial balance led to a strong deterioration of the financial balance of non-financial private sector (households and non-financial corporations) since 2002, and net financial assets of non-financial private sectors became negative: −62.2 per cent of GDP in 2007. Therefore, we could talk of a debt-led private expenditure type of growth.

During the third phase (2008–2013), non-financial corporations saw an improvement in their financial balance, which moved from −155.9 per cent of GDP in 2007 to −134.3 per cent of GDP in 2013. This noticeable improvement can be entirely explained by the decline in financial liabilities, which fell between 2007 and 2013 from 386 to 339 per cent of GDP.

The financial balances of financial institutions significantly declined in 2013: financial assets and liabilities fell 52.9 and 47.9 per cent of GDP, respectively. But the most relevant fact is that the financial balance of the sector became positive, oscillating between 8.8 per cent of GDP in 2013 and 14.4 per cent of GDP in 2010.

In the case of the general government, its financial assets increased to an unparalleled degree due to the impact of the banking rescue on Spanish public finances. As a result, the outstanding financial assets of general government rose between 2007 and 2013 from 30.7 to 61.7 per cent of GDP. The deterioration of public finances led to a skyrocketing public debt, leading to an unparalleled size of the financial liabilities of the general government (132.1 per cent of GDP in 2013). As a result, net financial assets have fallen from −17.8 per cent of GDP in 2007 to −70.4 per cent of GDP in 2013.

The financial behaviour of Spanish households differs substantially from that of other agents. Financial assets fell 25.8 p.p. of GDP in 2008, but started to rise again in 2009, reaching 183.2 per cent of GDP in 2013, a size similar to the levels of 2006 and 2007. Financial liabilities kept rising until 2010, when they reached 92 per cent of GDP. However, afterwards Spanish households began a process of heavy deleveraging, and their outstanding financial liabilities fell to 82.8 per cent in 2013 (9.2 p.p. of GDP lower than in 2010). As a result, between 2008 and 2013 the financial balance of Spanish households improved, and their net financial assets rose from 68.1 to 100.4 per cent of GDP.

As we analysed above, the current account balance has improved substantially in this period, and in 2012 and 2013 Spain had a surplus in the current account balance. This helped to slow the downturn and stabilise the positive financial balance of the external sector.

In sum, given that in this phase the external sector worked as the only driving force of the economic activity, and that the financial balance of households and non-financial corporations saw significant improvement, although the overall financial balance of the non-financial private agents remained negative, we can state that during the crisis the type of development of the Spanish economy has been one close to the export-led mercantilist type.

4.4 LONG-RUN EFFECTS OF FINANCIALISATION ON THE SPANISH ECONOMY THROUGH DIFFERENT CHANNELS

Financialisation and Distribution

The objective of this section is to check the hypothesis that financialisation contributes to redistribution of income from wages to profits and to higher income inequality for Spain (Hein 2010, 2011, 2012; Hein and van Treeck 2010). However, any conclusion must be viewed with caution. Our analysis is descriptive, and cannot provide a conclusive causal relationship between financialisation and changes in income distribution in Spain. These changes can be explained by other elements or economic policy measures that took place parallel to financialisation, such as fiscal policies or labour market reforms. Moreover, income redistribution could be explained by long-run elements that were operating in the Spanish economy well before the beginning of the financialisation process. This opens up the possibility that changes in income distribution could be the driving forces behind financialisation in Spain.

Given that financialisation began in Spain in the nineties, and gained momentum since 2000, our analysis of income redistribution will focus on this period. The data on the adjusted wage share (coming from the AMECO database) show that this share increased from 61.7 per cent of GDP in 1960 to 67.1 per cent of GDP in 1981. Since then, with the exceptions of the years 1991–1993 and 2007–2009, adjusted wage share has shown a declining tendency, amounting to 53.3 per cent of GDP in 2013, the lowest figure since 1960.

The declining wage share would suggest a potential relationship between financialisation and (functional) income redistribution from wages to profits. From the mid-nineties until 2007, Spanish wage moderation was considerable (in 2007 real wages were 1 percentage point lower than in 1993), which is difficult to explain given the economic growth and the performance of the labour market in the period (between 1995 and 2007, 7.8 million jobs were created, and the unemployment rate fell from 20 per cent to 8.3 per cent). Although financialisation may have affected real wages, wage moderation was also influenced by the voluntary wage moderation agreed between employers' associations and trade unions (Ferreiro and Gómez 2006, 2014a) and by the depressing impact on wage growth resulting from the temporary employment contracts, whose spread can be explained by the need of corporations to reduce wage costs in order to offset the negative effects of the high real interest of the late eighties and the nineties (Ferreiro and Serrano, 2001).

Table 4.1 shows the evolution of income property and their components:

Table 4.1 Property income (as percentage of Gross National Income)

	Property income	Interest	Distributed income of corporations	Other income
1985	24.83	22.76	1.94	0.13
1986	24.25	22.07	1.91	0.27
1987	25.83	23.44	1.98	0.41
1988	25.76	22.47	2.65	0.64
1989	28.19	25.15	2.44	0.60
1990	29.89	27.11	2.37	0.42
1991	30.25	27.11	2.75	0.39
1992	30.11	27.34	2.39	0.38
1993	32.14	28.66	3.03	0.45
1994	26.21	23.16	2.57	0.48
1995	33.62	28.70	3.53	1.38
1996	31.98	26.17	4.27	1.54
1997	26.76	21.28	4.50	0.98
1998	22.32	17.26	3.47	1.60
1999	19.33	13.88	3.64	1.81
2000	20.76	14.65	4.24	1.87
2001	21.36	15.28	4.68	1.40
2002	18.24	12.59	4.30	1.34
2003	16.47	10.45	4.54	1.47
2004	16.53	10.22	4.87	1.45
2005	17.65	11.14	5.07	1.44
2006	22.29	13.94	5.93	2.41
2007	28.13	18.95	6.27	2.91
2008	30.33	21.70	6.66	1.97
2009	21.66	13.55	6.43	1.69
2010	19.70	11.51	6.42	1.77
2011	22.13	14.03	6.25	1.85
2012	22.02	14.23	6.00	1.78

Source: Our calculations based on Spanish National Statistics Institute and AMECO database.

interest, distributed income of corporations (i.e., dividends) and other income (rents, reinvested earnings on direct foreign investment, and property income attributed to insurance policy holders). Interest is the main component of property income. Its series shows the existence of four phases: until 1995, with the exception of 1994, the share of interest in gross national income (GNI) had an upward tendency, peaking at 28.7 per cent in 1995. Between 1995 and 2004, its share fell sharply, reaching a minimum in 2004 (10.2 per cent). Between 2005 and 2008 interest started to rise again, reaching 21.7 per cent in 2008, but since then it started a new downward phase, reaching 14.2 per cent in 2012.

The sustained growth of the size of financial assets and liabilities implies that the changes of the volume of interest are mainly explained by the changes in the interest rates, i.e., in the profitability of financial assets. Until 1995 the rise in size of interest payments was driven by the joint effect of high interest rates and a larger size of financial assets-liabilities. Since 1995, the fall in interest payments would be explained by the fall in interest rates. However, since 2004 low interest rates were not enough to offset the big increases of financial assets-liabilities, thus leading to a phase of high growth on this component. This new phase ended in 2008, when the fall in interest rates led to the fall in interest payments.

Regarding the item ‘other income’, its value remained stable until 2005. Henceforth, there was a strong rise in the item ‘reinvested earnings on foreign direct investments’, which rose from 2.1 to 11.5 billion euros between 2005 and 2006. Since 2006, the volume of this income has fallen, although it stabilised at around 6 billion euros. Furthermore, in the case of households there is an important increase in the volume of ‘property income attributed to insurance policy holders’ in 2007, which rose from an average annual size close to 10 billion euros, to 14.3 and 15.6 billion euros in 2007 and 2008, respectively. Lastly, dividends, i.e., distributed income of financial and non-financial corporations, have grown continuously from the mid-nineties onwards, and as a result dividends are above 6 per cent of GNI since 2007.

Next, we shall focus our attention on the changes noted in the personal income distribution. According to data from Eurostat (Income and Living Conditions), the Gini coefficient of equivalised disposable income fell from 34 to 31 between 1996 and 2002, a fall related to the intense rise in employment and the fall in unemployment rate. However, since 2004 the inequality in income distribution increased very quickly, and it even accelerated at the beginning of the current crisis, peaking at 35 in 2012, although it fell to 33.7 in 2013.

Another indicator of the changes in income distribution is the ratio median-to-mean income: a declining ratio would imply a larger inequality

Table 4.2 Share of national equivalised income by deciles (per cent)

	D1	D2	D3	D4	D5	D6	D7	D8	D9	D10
1995	2	5	6	7	8	9	11	13	16	25
1996	2	5	6	7	8	9	10	12	15	26
1997	2	4	6	7	8	9	10	13	16	26
1998	2	5	6	7	8	9	10	13	16	25
1999	3	4	6	7	8	9	11	13	15	25
2000	3	5	6	7	8	9	10	12	15	25
2001	3	5	6	7	8	9	11	12	15	25
2004	2.6	4.7	5.9	7.1	8.3	9.5	10.9	12.6	15.1	23.3
2005	2.5	4.6	5.8	6.9	8.1	9.4	10.8	12.7	15.4	23.8
2006	2.4	4.6	5.8	7.0	8.2	9.5	10.9	12.7	15.2	23.7
2007	2.4	4.7	5.8	6.9	8.1	9.5	10.9	12.7	15.4	23.6
2008	2.2	4.7	5.9	7.1	8.3	9.4	11.0	12.8	15.4	23.3
2009	1.5	4.6	5.9	7.1	8.2	9.5	11.0	12.9	15.7	23.5
2010	1.3	4.3	5.7	7.0	8.2	9.5	10.9	12.9	15.8	24.4
2011	1.5	4.2	5.6	6.8	8.1	9.5	11.1	13.1	16.0	24.2
2012	1.5	4.2	5.6	6.8	8.0	9.3	11.0	13.0	16.0	24.8
2013	1.9	4.4	5.7	6.8	8.0	9.4	10.8	12.8	15.7	24.5

Note: Data for 2002 and 2003 are not available.

Source: Eurostat, Income and Living Conditions.

in income distribution, and vice versa. Using data from Eurostat (Income and Living Conditions), this ratio climbed from 82.1 per cent in 1996 to 88.9 per cent in 2004. In 2005 the ratio fell to 87 per cent and started to rise again until 2008 when it amounted to 88.8 per cent. Since then the ratio has fallen, and in 2013 amounted to 86.5 per cent. This evolution suggests a larger equality in income distribution up until 2008. However, with the current crisis, income distribution in Spain has become more unequal.

Table 4.2 shows the evolution of income distribution by deciles since 1995. The data do not show a significant change in income distribution, with the exception of the first decile, which shows a downward tendency, a sign of the worsening economic situation of the poorest people. Nonetheless, the current crisis has generated a less egalitarian income distribution. Thus, the share of national income corresponding to the two first deciles has declined whilst that of the two last deciles has increased.

The existence of an income redistribution process from the lowest to the highest incomes is more evident when we analyse the ratios between different income deciles: D10/D1, D9/D5, D5/D1 and (D9+D10)/(D1+D2). As Table 4.3 shows, in all cases we can detect an income redistribution process

Table 4.3 *Ratios between income deciles*

	D10/D1	D9/D5	D5/D1	(D9+D10)/(D1+D2)
1995	12.5	2.0	4.0	5.9
1996	13.0	1.9	4.0	5.9
1997	13.0	2.0	4.0	7.0
1998	12.5	2.0	4.0	5.9
1999	8.3	1.9	2.7	5.7
2000	8.3	1.9	2.7	5.0
2001	8.3	1.9	2.7	5.0
2004	9.0	1.8	3.2	5.3
2005	9.5	1.9	3.2	5.5
2006	9.9	1.9	3.4	5.6
2007	9.8	1.9	3.4	5.5
2008	10.6	1.9	3.8	5.6
2009	15.7	1.9	5.5	6.4
2010	18.8	1.9	6.3	7.2
2011	16.1	2.0	5.4	7.1
2012	16.5	2.0	5.3	7.2
2013	12.9	2.0	4.2	6.4

Note: Data for 2002 and 2003 are not available.

Source: Eurostat, Income and Living Conditions.

from the lowest incomes to medium and high incomes (above the fifth decile). At the beginning of the crisis, income distribution changed in favour of medium and high incomes and to the detriment of lowest incomes, and although after 2010 inequality declines, it is still higher than before the crisis.

The impact of the current crisis on income redistribution is more evident when we compare the income share of the poorest 5 per cent with that of the richest 4 per cent. Between 2007 and 2013, the income share of the poorest 5 per cent fell from 0.8 per cent to 0.5 per cent, but the income share of the richest 4 per cent has risen from 14.1 per cent to 14.6 per cent.

Financialisation and Investment

In Section 4.3 we ascertained that since the mid-nineties the gross capital formation increased substantially, becoming one of the main driving forces behind economic growth. In this sense, it is difficult to argue that financialisation in Spain has damaged the capital accumulation process. However, this does not mean the financialisation process has not affected the size and the financial sources of investments of non-financial corporations.

Table 4.4 Net operating surplus and property income resources of non-financial corporations (per cent of GDP)

	Net operating surplus	Property income	Net operating surplus + property income	Property income		
				Interests	Dividends	Other property income
1985	10.6	1.0	11.6	0.8	0.1	0.0
1986	11.5	1.4	12.8	0.7	0.2	0.4
1987	12.1	1.5	13.6	1.0	0.3	0.2
1988	12.2	1.6	13.8	0.9	0.4	0.4
1989	11.7	1.7	13.4	1.0	0.3	0.3
1990	10.8	1.6	12.4	1.2	0.3	0.1
1991	10.2	1.5	11.7	1.2	0.3	−0.1
1992	9.7	1.6	11.3	1.2	0.2	0.2
1993	10.6	1.5	12.0	1.5	0.2	−0.2
1994	11.9	1.7	13.6	1.2	0.2	0.3
1995	11.7	2.0	13.7	1.1	0.8	0.1
1996	11.2	2.0	13.2	1.0	0.8	0.2
1997	11.5	2.1	13.6	0.9	0.9	0.3
1998	11.4	2.0	13.4	0.8	1.0	0.2
1999	11.0	2.0	13.0	0.6	1.0	0.4
2000	10.4	2.7	13.1	0.9	1.2	0.6
2001	10.2	2.2	12.5	0.9	1.2	0.1
2002	10.1	2.3	12.3	0.9	1.3	0.1
2003	9.8	2.5	12.3	0.7	1.6	0.2
2004	9.8	3.5	13.3	0.7	1.8	1.0
2005	9.1	2.9	12.0	0.7	1.9	0.3
2006	8.7	3.9	12.6	0.8	2.1	1.0
2007	8.3	4.3	12.6	0.8	2.3	1.3
2008	8.5	3.6	12.1	0.9	2.5	0.3
2009	8.5	3.4	11.9	0.5	2.5	0.4
2010	9.5	3.4	12.9	0.5	2.4	0.5
2011	9.8	3.4	13.2	0.6	2.3	0.5
2012	10.3	3.2	13.5	0.6	2.1	0.5

Source: Our calculations based on Spanish National Statistics Institute, Annual National Accounts, Total economy and institutional sectors accounts.

One of the main features of financialisation is that the resources generated by non-financial corporations are increasingly dependent on income generated by the financial operations of the firm (property income), which is detrimental to the income coming from productive activity (net operating surplus).

Table 4.4 shows the evolution during the period 1985–2012 of the net operating surplus and property income of non-financial corporations. The volume of these resources has remained very stable, oscillating between 12 and 14 per cent of GDP. Nonetheless, there is a significant change in the size of each resource: net operating surplus fell from 10.6 to 8.3 per cent of GDP between 1985 and 2007, and property income rose from 1 per cent to 4.3 per cent of GDP. The current economic crisis has contributed to a partial reversion of this tendency, and in 2013 property income fell up to 3.2 per cent of GDP, whilst the net operating surplus increased up to 10.3 per cent. As a consequence, since 1985 property income represents a higher share of the sum of net operating surplus and property income of non-financial corporations: 18.5 per cent in 1997 and 52.2 per cent in 2007. Although the current crisis has implied a decline in this share, in 2012 it still amounted to 31.3 per cent, twice the average share of the nineties.

If we focus on the evolution of the components of property income resources, namely interest payments, distributed income of corporations (dividends) and other property income (rents, property income attributed to insurance policy holders and reinvested earnings on direct foreign investment), it is interesting to note that while other property income (mainly because of the increase in reinvested earnings on direct investment) and dividends have increased in size as a percentage of GDP, interest has had a sustained downward tendency, despite the rise in the size of financial assets of non-financial corporations, denoting the fall in the average profitability of these assets. As a consequence, Spanish non-financial corporations have reduced their dependency on resources coming from net operating surplus and interest, while dividends and profits resulting from their direct investments abroad have gained weight.

Financialisation may also have involved a change in the use of the resources of non-financial corporations. Table 4.5 shows the distribution of these resources between interest paid, dividends and retained profits. Until the beginning of the crisis, dividends paid by non-financial corporations grew. Contrary to what could be expected, the crisis has not implied a fall in dividends but merely a stabilisation.

In the case of interests paid, these began to fall in the year 1992, although after 2000 they climbed due to skyrocketing financial liabilities. This process ended abruptly in 2008 with the reduction of interest rates.

Retained profits rose sharply until 2004. Subsequently, they declined until 2008. With the beginning of the crisis, retained profits recovered and after 2010 were at the same levels as one decade ago. Therefore, in the last decade the greater payment of interest and dividends has gone at the expense of lower retained profits. The declining retained profits, in a context of increasing investments, implied a rising dependence on external

Table 4.5 Use of resources coming from net operating surplus and property income of non-financial corporations (per cent of GDP)

	Interest	Dividends	Retained profits	Other uses
1985	6.50	1.30	3.65	0.13
1986	5.62	1.45	5.61	0.13
1987	5.95	1.71	5.81	0.13
1988	5.62	2.18	5.87	0.18
1989	5.67	1.84	5.71	0.18
1990	5.97	1.56	4.67	0.19
1991	5.96	1.65	3.90	0.20
1992	6.14	1.19	3.76	0.20
1993	6.29	1.06	4.52	0.17
1994	5.79	1.58	5.99	0.28
1995	5.31	2.02	6.26	0.10
1996	4.66	2.36	6.11	0.09
1997	4.19	2.61	6.75	0.09
1998	3.68	2.84	6.80	0.07
1999	3.29	2.77	6.84	0.06
2000	2.88	3.41	6.73	0.06
2001	3.44	3.55	5.33	0.14
2002	2.93	3.40	5.96	0.06
2003	2.65	3.57	6.05	0.05
2004	2.82	3.89	6.50	0.04
2005	2.98	4.34	4.61	0.04
2006	3.65	4.79	4.11	0.04
2007	4.94	4.63	2.99	0.05
2008	5.51	4.48	2.07	0.04
2009	3.15	4.77	3.96	0.04
2010	2.91	4.42	5.57	0.04
2011	3.47	4.36	5.30	0.04
2012	3.14	4.19	6.16	0.04

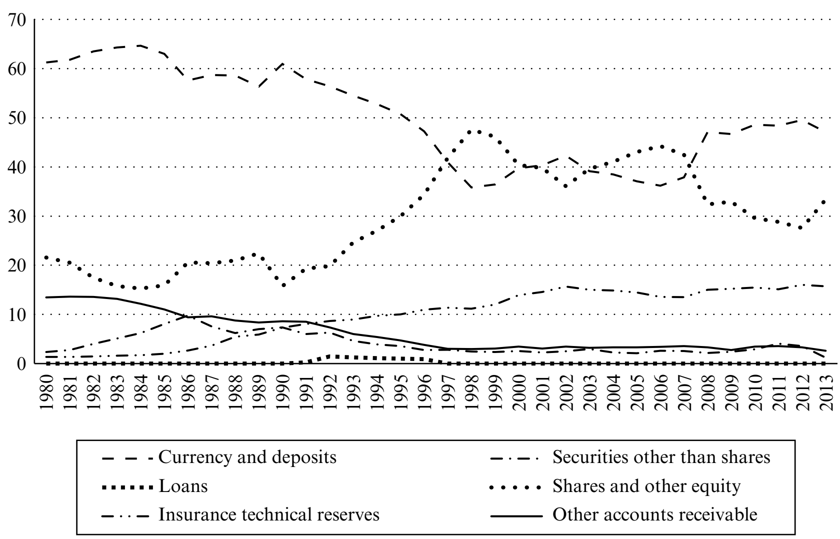
Source: Our calculations based on Spanish National Statistics Institute, Annual National Accounts, Total economy and institutional sectors accounts.

funding to finance investments. This pattern changed with the financial and economic crisis. The crisis has led to higher retained profits, which can be explained by the deep constraints on the access to external (banking and non-banking) funding suffered by non-financial corporations. The recovery of retained profits did not happen at the expense of cuts in dividends, whose size has remained nearly unchanged, with small variations. Higher dividends were fuelled by the fall in paid interests and larger net operating surpluses.

Financialisation and Household Consumption

Although household consumption was one of the main driving forces of the Spanish economy since the nineties, its size, as a percentage of GDP, did not increase during the financialisation process. This does not mean that this process has not affected the real and financial behaviour of Spanish households. Figures 4.1 and 4.3 have shown the fast growth of household financial liabilities and the resulting decline in the size of their net financial assets until the beginning of the crisis. But, besides altering the size of household financial balance sheet, financialisation has also changed its composition. As Figure 4.4 shows, until the onset of the current financial and economic crisis, there had been a fall in the share of currency and banking deposits, which fell from 60 per cent in the eighties to 36.2 per cent in 2006. The declining deposits were offset by the greater insurance technical reserves (related to the larger size of pension funds) and, mainly, by the larger size of shares and other equities. With the current crisis, however, the fall in shares and other equities has gone hand in hand with an equivalent rise in currency and deposits.

Banking loans are their main component of household financial



Source: Our calculations based on Bank of Spain, Boletín Estadístico, Financial Accounts of the Spanish Economy, Financial Accounts.

Figure 4.4 Household financial assets (as percentage of total household financial assets) liabilities. Although their size remained constant around 75 per cent of total financial assets during the eighties, their share began an upward tendency since the mid-eighties, and after 2004 they have represented more than 90 per cent of total liabilities.

The bulk of credit to Spanish households is related to the purchase of housing: these credits amounted to 71.4 per cent of total loans and credits to households in 2007 and 75.4 per cent in 2013. Consumer credit has a minority and declining share: they only amounted to 12.4 per cent in 2007 and 8 per cent in 2013. When we measure banking credit to households as a percentage of GDP, similar results are obtained: the sum of loans to households for financing productive activities, consumer credits, and other purposes rose between 1997 and 2009 from 12.7 to 20.4 per cent of GDP. Since then, they have fallen to 16.2 per cent of GDP in 2013. Conversely, loans for house purchase rose sharply from 19.4 per cent of GDP in 1997 to 60.5 per cent of GDP in 2010, dropping to 56.8 per cent of GDP in 2013.

In this sense, we can argue that financialisation fuelled a housing bubble in Spain, stimulating the purchase of houses by the combination of lower interest rates and greater available external funding. The fall in nominal interest rates meant that despite the increase noted in household financial liabilities, the burden of this borrowing has fallen since the early nineties: in 1992, interest paid by households amounted to 11.4 per cent of their gross available income, but only 1.9 per cent in 2004. Although, interest paid increased after 2004 (reaching 5.3 per cent in 2008) it subsequently fell to 3 per cent in 2013.

The availability of abundant and cheap external funding went hand in hand with a declining savings rate after 1995, and, thus, in 2006 the gross savings rate amounted to merely 10.4 per cent. The financial crisis led to a huge rise in the household savings rate, peaking at an unparalleled 18 per cent in 2009. This increase in the savings rate at the beginning of the crisis could be explained by the deleveraging of Spanish households, who aimed at reducing their financial liabilities, and the uncertainty resulting from the rising unemployment that would have led to higher precautionary savings (Estrada et al. 2014). Since then, the savings rate has declined and in 2012 the household savings rate (10.5 per cent) was similar to that seen before the crisis. It should be noted that between 2009 and 2012 household gross available income fell by 5.5 per cent. The low savings rate of 2012 may therefore be related to declining resources of Spanish households and greater problems with saving.

Financialisation and the Current Account

In Section 4.3 we were able to ascertain that external imbalances in Spain rose increasingly since the nineties. In the first decade of the current century, the goods and services and current account balances reached unparalleled deficits: 6.7 and 10 per cent of GDP, respectively, in 2007. After 2008, Spanish external imbalances have rapidly adjusted, and in 2013 both current account and goods and services balances exhibited surpluses (0.8 per cent and 2.4 per cent of GDP, respectively).

The constant deficits in the balance of payments have led to a sustained increase in Spain's external debt, with the net international investment position skyrocketing to −982 billion euros in 2009. Actually, this deficit continued rising until 2013, when it amounted to 1,004 billion euros. However, the increase in the deficit that has been taking place since 2010 is explained by the larger debtor position of the Bank of Spain with the Eurosystem. Excluding the Bank of Spain, the net debtor position of Spain has shown a significant adjustment: from 1,026 billion euros in 2009 to 863 billion euros in 2013.

The rising external debt of the Spanish economy can be explained by the worsening of the current account balance, a reflection of the declining competitiveness of the Spanish economy. The competitiveness problems are related to the inflation differential with the main trade partners, mainly those belonging to the Euro area, resulting in a loss of price competitiveness of Spain: whilst between 1993 and 2013 the CPI for the Euro area (EU-18) increased 54 percentage points, in Spain it increased 77 percentage points.

The higher inflation rates, combined with a lower growth of productivity, have meant that the growth of the nominal unit labour costs (NULCs) was higher in Spain than in other countries in the Euro area. Between 1999 and 2009, NULCs increased in the Euro area by 22.7 per cent, while in Spain they increased by 37.7 per cent. However, this does not mean that wage growth is the only reason of the lower competiveness. If we analyse the evolution of real unit labour costs (RULCs), we can see that real ULCs have fallen in Spain more than in the Euro area: despite the acceleration in RULCs, Spanish RULCs were 9.3 percentage points lower in 2013 than in 1999 (1.3 p.p. lower in the case of the Euro area).

4.5 TRANSMISSION CHANNELS OF THE FINANCIAL CRISIS INTO THE SPANISH ECONOMY

As we have previously argued, the economic and financial crisis has affected Spain more intensely than most European countries. Excessive levels of private debt have transformed Spain into an economy highly dependent on external funding. The collapse of international financial and inter-banking markets since summer 2007 showed the weaknesses of the pillars that supported the Spanish growth model, and showed the need for financial and non-financial private agents to adopt measures to deleverage and reduce their indebtedness, which resulted in an abrupt decline in private demand. In this sense, the Spanish crisis is very similar to what happened in the other European economies, and has common roots. However, these elements alone do not explain the greater extent and prolonged duration of the crisis in Spain.

The liabilities of the Spanish private sector were not larger than in other European economies. Moreover, the size of the banking crises (in terms of the dimension of the affected institutions or the amount of the public support to the banks with problems) has also been greater in other countries, such as the United Kingdom, the Netherlands or Germany. The size of the external imbalances and the external debt were larger than in other countries, but it is not evident that they alone explain the larger impact of the economic crisis in Spain.

Although we are unable to conduct an in-depth analysis for reasons of space, we should like to point out two particular elements of the economic crisis in Spain that make it different from other crisis episodes. The first element has to do with the restructuring process of the Spanish financial system. The impact of the public support for credit institutions on public debt has not been greater than in other European Union countries (see European Commission 2014). However, the impact of public budget balance has been substantially greater. The delay in the acknowledgement of the existence and depth of the crisis in certain segments of the credit system contributed to an increase in the size of the public support needed in comparison to if the banking rescue had happened earlier.

Furthermore, the public rescue of Spanish banks took place later than in other European countries. In most European countries the banking rescue took place before the burst of the Greek crisis. The result was that there was no contagion effect from the banking crisis to the sovereign debt crisis. This was not the case with Spain. The banking crisis in Spain went hand in hand with a sovereign debt crisis that forced the Spanish Government to request the financial support of European Union institutions in July 2012 due to its inability to ensure that the resources required to support the failing banks entered the financial markets.

The delay in the bank bailout led to major uncertainty as to the true situation facing Spanish credit institutions, which transferred to the whole financial system and to the funding of the sector to non-financial agents, deepening the crisis because of the credit constraints suffered by non-financial agents (International Monetary Fund 2014).

The second element is related to the conduct of fiscal policy, mainly in the years before the crisis (Ferreiro, Gómez and Serrano 2013, 2014b, 2014c; Ferreiro and Serrano 2012a, 2012b). Although Spanish fiscal policy adopted a countercyclical restrictive stance in the years 2005 and 2006, given the dimension of the domestic (inflation) and external (current account deficit) imbalances, fiscal policy should have adopted a more restrictive stance. Moreover, the design of fiscal policy did not take into account the excessive indebtedness faced by households and non-financial corporations. In fact, the tax cuts adopted since 2006, mainly in the personal income tax, lent impetus to private borrowing by rising household available income in a context of low (nominal, but also real) interest rates.

Furthermore, fiscal policy adopted a procyclical expansionary fiscal policy in the years 2006 to 2008, based on a combination of expenditure increases and direct tax cuts implemented in 2006 and 2007, which meant that the public budget balance fell from a surplus amounting to 2.4 per cent of GDP in 2006 to a deficit amounting to −4.5 per cent in 2008, the year before the onset of the crisis in Spain. Besides leading to an over-heating of the Spanish economy, which fuelled private agents' debt, this faulty fiscal policy exhausted the space for an effective expansionary fiscal policy during the crisis. Actually, the implementation of expansionary fiscal measures meant that public deficit peaked at 11.2 per cent of GDP in 2009, an unsustainable figure that led to the necessary measures of fiscal consolidation after 2010, and that, undoubtedly, increased the negative impact of the financial and economic crisis.

4.6 SUMMARY AND CONCLUSIONS

The financialisation process of the Spanish economy came later than in most other advanced economies: it began in the mid-nineties and gained momentum after 2000, until the onset of the financial crisis in 2007.

This process has led to greater indebtedness of private agents, changing their financial and non-financial behaviours. In the case of households, there has been a change in the composition of their financial assets, with shares and other equities gaining weight to the detriment of banking deposits, at least until the current crisis. In the case of financial liabilities, the share of loans has remained nearly unchanged. The main purpose of these loans has been housing purchases. Thus, we can argue that financialisation in Spain indeed contributed to the housing bubble of the 2000s.

Greater household borrowing, therefore, has not gone hand in hand with an increase in the share of household consumption in GDP, despite the creation of many jobs, which could be explained by the stagnation of real wages.

In fact, although since the mid-nineties domestic demand has been the main driving force behind the Spanish economy, investment has been the component with the highest growth, which in turn has led to an increase in the share of GCF in GDP. However, this has not been the only effect of financialisation on the behaviour of non-financial corporations. The process has gone hand in hand with a change in the balance sheet of non-financial corporations. On the one hand, it has increased the size of property income in the primary resources of non-financial corporations. On the other hand, there has been a shift in the composition of primary incomes of these firms, with an increase in the size of interest paid and dividends, to the detriment of retained profits.

The greater availability of external financial resources has allowed an excessive increase in the external imbalances of the Spanish economy, both in terms of the current account deficit and the external debt. This high dependency of Spain on external funding has meant that the collapse of international financial markets has had more serious real consequences than in other neighbouring economies.

Lastly, we should like to emphasise the responsibility of the mistakes made in the management of the crisis for the extent and prolonged duration of the crisis.

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