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COMMENTARY

Budget Austerity Program in Spain

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The decision to cut budget spending announced by Prime Minister José Luis Zapatero on 12 May is part of the EU's plan for stabilization of the financial situation in the Eurozone and will help to increase the credibility of Spain and the EU, and calm the mood on the markets. Whether this situation can be maintained will depend however on Spain's plan being put into action, and also upon completion of changes in those Eurozone countries that are facing serious difficulties with their public finances (Portugal, Spain, Italy and others).

Spain's austerity budget has come about at a time of deterioration of the condition of its public finances and waning confidence in its economy. In 2009 Spain's deficit rose six percentage points to 11.4 % of GDP, the national product fell by 3.6%, and unemployment reached almost 20%. Just before the end of April this year the rating agencies lowered Spain's credit rating. The European Commission and Member States started to demand decisive action from Spain to repair its public finances as part of the EU's Eurozone stabilization plan.

The plan provides for budget cuts—of €5 billion in 2010 and €10 billion in 2011—which will allow the deficit to be reduced to 6% of GDP within two years and a return to the maximum GDP allowed in the Eurozone of 3% of GDP in 2013. The plan envisages a cut in salaries in the public sector of 5% from June 2010, and even as much as 15% for cabinet ministers and senior officials, as well as freezing of all salaries in 2011. It provides for cuts in social spending, for instance suspending adjustment of pensions for inflation in 2011, abolition of the one-off childbirth payment, and reductions in subsidizing of medicine. A key element of the plan is reduction in spending on public investments by €6 billion and development aid by €600 million.

The plan represents a determined departure from the strategy for combating the crisis employed up to now by Prime Minister Zapatero, who, despite the recession, which began at the end of 2008, has opposed budget cuts, especially in the areas of social spending and investments. The economic revival and employment program adopted in January 2009 provided for an increase in public spending of €21billion. The signs of a shift in approach could be seen at the beginning of 2010, when it turned out that the fall in GDP and public finance deficit were significantly higher than anticipated. In this situation the government adopted the first austerity plan in January this year, presuming a reduction in spending of €50 billion by 2013. The additional €15 billion that Zapatero has announced in recent days may merely seem to be supplementing the previous decisions. This decision—which is very difficult for the prime minister's supporters and the unions to accept—is significant politically, as it will lead to cuts in social spending, which was one of the pillars of Zapatero's government's manifesto. In the medium term—parliamentary elections are due to take place in the spring of 2012—changes can be expected on the Spanish political scene.

The cuts that Zapatero has announced in budget spending are part of the EU's plan to stabilize the financial situation in the Eurozone. The decision to make further cuts shows that Member States are capable of making substantial adjustments to their economic policy, including even cutting pay and spending on welfare. The announcement was welcomed by the European Commission and international financial institutions, such as the IMF. The European bourses reacted positively. The EU stabilization plan, combined with the rescue plan for Greece, Spain's austerity plan, and also similar measures in other EU states having problems with public finances (Portugal and Italy, inter alia) will help to raise the EU's credibility and calm the mood on the markets, but whether this scenario can be sustained will depend on whether the decisions announced are carried through.

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