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Spanish state

Rescue or kidnapping?

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On June 29, 2012 the European Council reached an agreement to allow the direct recapitalization of Spanish banks and try to relieve pressure on the sovereign debt markets. This agreement amends some of the conditions initially laid down for the rescue of the Spanish banking sector, and is being presented by the government as a genuine success in Brussels.

In order to break the vicious circle between private banking debt and sovereign debt, the agreement empowers the European Stability Mechanism (ESM) to directly recapitalize Spanish banking institutions, so that the funds advanced by that institution are not included as additional public debt. A second novelty referred to in the agreement is that the ESM will not constitute a priority creditor in the event of non-payment (which will prevent further pressure on the Spanish risk premium).

However, the agreement not only presents important areas of obscurity, but it also maintains the perennial obstinacies of Brussels. While lighting a candle in a dark tunnel can save us some stumbling, it does not cause the tunnel to change its destination.

The ESM cannot provide funds directly to the Spanish banking sector until the ECB assumes the role of sole supervisor of the European banking system (a requirement raised by Merkel). This new transfer of national sovereignty - certainly complex and requiring a difficult consensus among the countries of the Euro area - may take many months yet. For this reason, the rescue of the Spanish banking sector will start in the “classical” manner: the European Financial Stability Facility (EFSF) granted a credit line of up to 100,000 million Euros to the Fund for Orderly Bank Restructuring (FROBR), which raises the Spanish public debt by 10 additional points on GDP. This new pressure associated with the increase in interest on the debt will have to be compensated for by more cuts in social expenditure so that the deficit does not increase, as the minister De Guindos has recently announced the. Only once the ECB assumes full powers of monitoring will the rescue will be transferred to the ESM and the direct recapitalization of banking become possible.

On the other hand, as of now it is not clear whether nationalized entities are eligible for such direct recapitalization. In the event that they are not - and since this is precisely where extra funds are needed - the agreement would have little use for Spain.

But even when progress is made in banking and fiscal union and the ECB reaches full powers of supervision, the rescue to the Spanish banking sector entails tough conditions. Although the provision for bank recapitalization runs through the ESM and the Spanish state loses its role as intermediary and guarantor, Spanish citizens will with this agreement lose the right to decide on the future of their banking system.

Moreover, as stated in a note made public by the European Council of June 29, the recapitalization “would be based on the appropriate conditionality, [...]” which should be specific for each entity, specific to each sector or at an economy-wide scale”. Thus, the conditionality associated with the loans will not be limited only to the private sector, but can reach out to the whole of the economy.

The agreement not only does not change the orientation of the policies of cuts imposed from Brussels - which have pushed our economy into recession - but rather deepens it. To the extent that the intervention of the EFSF and the ESM is subordinated in the agreement to the member states meeting the requirements of the Stability and Growth Pact and attaining a deficit of 3% of GDP by 2013, the troika (the European Commission, IMF and ECB) will not only supervise Spanish banking reform, but the government's economic policy. The orientation there is no doubt, will be maintained: to apply all possible measures to release resources which ensure the payment of public and private debt to creditors.

The “actually existing” rescue of the Spanish banking sector will require new adjustment measures to achieve this chimerical goal of reducing the deficit to 3% by 2013. We are on the eve of a significant increase in VAT (a tax that especially affect those on the lowest incomes), which will surely increase the taxation of some basic goods and services from a super-reduced type (4%) to a small rate (8%), or from the latter to the standard rate (18%). Another expected change will be the elimination of the tariff reduction on the purchase of housing, which - although it would encourage rented housing - could simultaneously stiffen the economic situation for those asphyxiated families faced with mortgage payments. Further reductions in wages and public sector employment will be sought - and very probably redundancies - as well as new attempts to increase the retirement age.

The consequences of the rescue of the Spanish banking sector - with or without direct recapitalization - will be bitter for workers and especially for the lowest income families. The debt owed by the Spanish financial institutions to foreign banks, much of it linked to the real estate business, will be paid at the expense of further closing operating theatres, laying off teachers and cutting rights.

But these measures do not even guarantee that credit will again flow to the Spanish economy, inasmuch as they don't solve the problem of the failed loans of promoters and builders, the real estate assets accumulated by the banks or the overvaluation of such assets. Adjustment measures in a “balance sheet recession” like the current one - where all the actors try to reduce their debt simultaneously – only deepen the crisis and progressively increase the default of banking assets. The sharp decline of Spanish household savings since 2010 savings - linked to lower incomes, wage cuts and the depletion of public benefits - is an example of this trend.

Also, the rescue of the Spanish banking sector does not eliminate medium-term risks of contagion of other countries. As shown by the Greek economist Yanis Varoufakis [1], to the extent that the financing of the EFSF and the ESM is based on the principle that all debts incurred by these institutions must be separable and attributable to a single country, its continued use necessarily increases the debt ratio on the GDP of the rest of countries not rescued by placing them in positions of increasing fragility.

Faced with this socialization of banking losses (charged to the Spanish and European citizens), it is necessary to put forward an alternative involving reversing the austerity measures and the employment counter-reforms, by demanding a moratorium on the payment of the debt to identify and cancel that part of it which is illegitimate, and expropriate private banks that do not hold to a strict regulation aimed at socially oriented credit – in favourable financial conditions – for socially useful activities.

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[1] “Why Italy, why Spain and why the EFSFS size does not matter”.