The Urban, Economic, and Social Consequences of the Spanish Real Estate Model

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The Origins of the Problem: The Francoist Dictatorship

Spain's forty years of dictatorship left deep traces on the subsequent period of democracy. One of these is the enormous reliance of the economy on the banking–real estate complex, which plays a pivotal role in the configuration of the nation's economic space.

The Francoist regime held as one of its extremely conservative and primary political objectives the stimulation of home ownership as a basic aspect of citizenship, thus reinforcing the country's conservative culture. In 1957, Falangist leader José Luis Aresse, then the minister for housing, said, "We want a country of proprietors, not proletarians."[1] Because of these policies, Spain went from being a society in which renting was the primary means of securing a dwellingto one where a system of making payments to financial institutions (banks and *cajas*, or local and provincial savings banks) became generalized as a way to achieve the desired status of ownership.

[1] Isidro López and Emmanuel Rodríguez, *Fin de ciclo: Financiarización, territorio y sociedad de propietarios en la onda larga del capitalismo hispano (1959–2010)* (Madrid: Observatorio Metropolitano, 2011).

In the final years of the dictatorship, 70 percent of dwellings were occupied by homeowners, although for the millions of Spaniards who had to spend years paying off mortgages the ownership was not so much theirs as the bank’s. Much of the population was mortgaged and therefore dependent on the banks and *cajas*. The latter began to behave more and more like the former in an effort to optimize the profits on their loans.

Across all age groups, real owners were a minority, although the mortgage system had less of a grasp on the elderly, who were at the end of their lives and mortgage payments. Most homeowners thus spent most of their working lives paying off their mortgage loans. From a country of tenants, Spain had become instead a country of individuals saddled with mortgage debt.

The Continuation of Public Policies during Democracy

Policies established during the Francoist period were continued under democracy. Successive governments offered numerous incentives to encourage the population to buy dwellings rather than rent them. Foremost among the incentives was a tax deduction for mortgage payments. The deduction, aimed at homeowners, actually meant a public subsidy for the banks and estate agents who took advantage of the subsidized tax cuts to raise the prices of both homes and mortgages.

In 2007, before the start of the crisis, the property system (comprising both those who lived in a mortgaged dwelling and those who already owned their own homes) had come to represent no less than 87 percent of all dwellings, the largest percentage of home ownership in the EU-15 (the group of European Union countries with a level of economic development similar to Spain). Thirty-five percent of families possessed more than one dwelling. The upper and upper-middle income brackets expanded their real estate ownership most intensely. Owning two or more houses became a status symbol. Rentals fell to a housing market share of only 13 percent of residential properties and have remained at that level, one of the lowest in the EU-15 (in France rentals are 38 percent of the market, in Great Britain they are 32 percent, and in Germany they are 57 percent).

This situation partly explains the inflexibility that characterizes the Spanish labor market, because owning a home determines the proprietor's place of residence. Territorial mobility is thus greatly limited because people think long and hard before going off to work in another part of the country, especially if doing so means having to sell one's house or clear one's mortgage. This primary reason for the scant mobility of the work force has been given hardly any coverage in the media despite being one of the principal factors preventing individuals from moving from one population center to another in accordance with their needs. Reluctance to sell one's home also explains why many people travel long distances between home and work, a practice whose subsequent costs are at once human (stress during transportation is one of the main causes of accidents in Spain), economic (a Spanish family spends 3 percent of its available income on transport), and environmental (atmospheric pollution, caused in part by means of transport, has reached levels in several Spanish cities that are well above those permitted).

The proliferation of homeowners has led to an increase in housing prices that is out of all proportion to the rest of the economy. Housing prices annually grew by an average of 12 percent from 1997 to 2007, with an especially accentuated growth of 20 percent a year from 2003 to 2006.[2] In 2008, the price of housing represented no less than 7.7 times the national family income, whereas in the United States, for instance, the figure was only 4.8 times.

Housing prices far outstripped the growth of the economy. The greater demand for housing, itself the result of the growth of the population (particularly the immigrant population), was one of the causes of the housing bubble but not the principal one. The principal cause lay instead with the speculative practices of the banking–real estate complex. When the bubble burst, it gave rise to the enormous financial (lack of credit) and economic (scarce demand) problems Spain is experiencing today.

How Did the Banking–Real Estate Complex Emerge?

To answer this, we must ask ourselves three questions that are rarely posed. We must ask, for example, why did the banking–real estate complex grow so fast? What was the reason for the rapid growth of the

[2] According to the National Institute of Statistics.

banking sector? And why did the real estate sector grow equally swiftly? The latter two questions are related, bound up with the same causes, which have to do with Spain's unequal distribution of income, which is among the most unequal in the EU-15.

One of the most important recent developments in the Spanish economy has been the reduction in earned income. Salaries have fallen in real, not nominal, terms. The difference is important because analyses of salaries and purchasing power must deduct the nominal salary, the impact of inflation, and other factors affecting the actual purchasing power of individuals. The decline in earned income obliged families to go into debt to buy a flat, something they were able to do thanks to the ample credit available partly as a result of Spain's entry into the euro, partly because most families were (and still are) required to put their houses up as collateral to obtain credit, and partly because of state incentives for mortgage holders and mortgage providers.[3] Because housing prices were rising swiftly, families could obtain credit and go into debt.

Such is the origin of the enormous accumulation of private debt in Spain, which stands at 87 percent of gross domestic product (GDP), a higher percentage than the public debt (68 percent) that has been the center of media attention. Private debt is also the reason for the

[3] The Socialist government eventually did away with the mortgage tax deduction for annual incomes of more than €24,000 (the change did not apply to existing mortgages, however).

considerable growth of the banking sector: the greater the debt, the greater the profits. Many domestic and international studies show that as income inequality rises in a country (with an increasingly higher concentration of income in a minority of the population) so, too, does the level of debt of most of the population rise.[4] Simultaneously, the rate of growth of the credit-based financial sector—that is, what are popularly known as the banks—also increases.

Spain provides confirmation of this. According to Eurostat, the European Union Data Agency, Spain leads the EU-15 in measures of income inequality and at the same time has one of the highest percentages of families in debt. The first—inequality and the poor purchasing power of most citizens—leads to the second.

Consequences of Family Debt (Lack of Demand) and the Concentration of Income (Speculation)

The banks and the *cajas* that behaved like banks in order to optimize their interests lent money so that people could obtain mortgages and buy houses. The fall in salaries that determined the growth of debt created enormous economic, social, and human problems. According to figures from the Bank of Spain,[5] the percentage of families who spent more than

[4] See Doug Orr, Marty Wolfson, and Chris Sturr, eds., *Real World Banking and Finance*, 6th ed. (Boston: Economic Affairs Bureau, 2010).

[5] Banco de España, *Boletín económico* 37 (December 2007).

40 percent of their income on paying their mortgages rose from 42.2 percent in 2002 to 70.9 percent in 2005. This increase was not so much a result of the increase in credit facilities, as the financial institutions maintain, but of the reduction in salaries. The percentage of workers earning less than €18,500 euros rose during the same period from 57.8 percent to 60 percent. In the meantime, business dividends grew by an average of 30 percent—42 percent for the financial sector.

One other factor explains the huge growth of the banking sector, and it, too, has to do with the distribution of income in Spain. The reduction in earned income meant diminished purchasing power for the population and thus a fall in the demand for goods and services. As sales of cars, bicycles, suits, and other consumer goods started to decrease, this sector of the productive economy became relatively unprofitable. Very rich people who deposited their money in banks therefore preferred to invest in areas where profitability was higher than that of the productive economy. One of these areas was real estate speculation. The relationship between the banking and real estate sectors established them as an enormous power bloc that, together with the construction sector, became the engine of the economic growth known as the "Spanish miracle." The "miracle," however, was partly based on speculation, and its many accomplices included public authorities. Local governments, whose main source of income was property taxes, saw their earnings rise considerably. The Bank of Spain, theoretically the regulator of the banking sector and thus responsible for foreseeing and preventing bubbles by protecting and guaranteeing credit, relaxed its regulatory function, often favoring the interests of the banking sector over those of the users, the citizens and small and medium-size enterprises that needed credit.

All this occurred in spite of the warnings of the Bank of Spain's own inspectors. This was the point at which the image of Spain's financial system as being the most solid and efficient of any in existence started to spread through economic and financial circles. In an example of the confusion of efficiency with power, the hegemony of the complex formed by the banking, real estate, and construction sectors became widely accepted—after all, they represented 10 percent of GDP and were the axis and engine of the supposed economic miracle.

The importance of the banking–real estate–construction complex in the Spanish economy is comparable to the importance of the military-industrial complex in the economy of the United States, though the rise of the U.S. military-industrial complex has at least led to collateral measures for stimulating the creation of productive assets, such as the Internet (although that might have been developed more efficiently through investment in other sectors of the economy). In Spain, however, the banking–real estate–construction complex had no collateral stimulating effect. On the contrary, it impoverished the economy and held back its recovery by absorbing many of the resources that might have been invested in more productive areas. During the boom years, many young people abandoned their studies to make fast money. (The lure of money to be made in the new complex was one of the main reasons for Spain’s school dropout rate.) When the housing bubble finally burst, economic development stagnated, and everything gained in the years of economic bonanza was lost.

The Burst of the Real Estate Bubble and Its Consequences

The bursting of the real estate bubble also detonated the financial and economic crisis in Spain. The banking sector, whose liquidity came largely from foreign banks—especially those of France and Germany—found itself in a vulnerable position. Besides becoming the proprietor of some three million empty dwellings, it encountered problems deriving from its dependence on European financial capital, which was itself highly contaminated by the toxic products that had reached Europe from the United States. The consequence was the collapse of credit, which mainly affected the mortgaged population and small and medium-size entrepreneurs. The resulting fall in demand was then aggravated by an enormous rise in unemployment. From 2004 to 2006 Spain had created 2.4 million jobs. Almost all of these were then lost over a subsequent two-year span. Half of these jobs belong to the construction industry.

The role public authorities played in the burst of the bubble cannot be ignored. The Bank of Spain closed its eyes to the speculative practices of the banking sector. Something similar occurred in the United States, where the bursting of a real estate bubble had similar consequences. In both countries the bank regulators, who ought to have anticipated these speculative activities, failed to do so. The analyses carried out on the crisis have revealed accounting practices whose purpose was to conceal the true net worth of the banking sector, which was the largest owner of empty dwellings in Spain. The paradoxical and profoundly inhuman situation resulting from this is that while millions of Spaniards find obtaining a dwelling to be difficult, three million homes are empty. Furthermore, the banks refuse to lower the price of the dwellings they possess and so impede the reactivation of the market in this sector. Housing prices have fallen by only 17 percent during the period of the crisis, despite calculations that real estate is overvalued by 30 percent.

The measures adopted by the state have been insufficient. Dean Baker, a founder of the Center for Economic Policy Research and a highly respected economist specializing in real estate matters in the United States, suggested an annual 5 percent tax on the value of unoccupied dwellings. Alternatively, legislation could have been enacted prohibiting housing from being kept empty—in effect, forcing such property to be rented. Such measures have been applied in other countries but have not been considered by either the central or the regional governments in Spain.

Another consequence of the burst of the bubble in Spain has been a reduction in the state's income. The percentage of state income Spain collects through taxes on earned income, 32 percent, is the lowest in the EU-15 (the average is 44 percent). Three other factors have contributed to the drop in state income. The first is a reduction of taxes on higher income brackets that has been in effect for the last fifteen years. The second is the enormous rise in unemployment, which has reached the highest percentage ever known, 22 percent, and is at 48 percent among the young. The third is economic contraction, the result of the fall in demand.

The reduction in state income has given rise to the problem of the public debt, which, although lower (68 percent of GDP) than the Eurozone average, has been subjected to a large-scale speculative attack by the financial markets. The markets have little confidence in the viability and credibility of the Spanish banking sector, excessively bound up as it is with the real estate sector, or in the ability of the state to pay its debt, given its low income. For this reason, the banking–real estate complex has also been a determining factor in the problem of the public debt, whose solution is wrongly being sought in cutbacks in social programs and labor rights (which had nothing to do with the crisis the country is now suffering). Spain, which has the lowest public social expenditure per inhabitant in the EU-15, is nonetheless reducing that spending still further. The public debt crisis cannot be attributed to a nonexistent excess of public spending (including public social expenditure), a misinterpretation reflected in the public policies of austerity in social spending that successive central and regional governments have been implementing during these years of crisis. The problem lies rather in the scant resources of the state at both the central and regional levels and in a lack of confidence in the solidity of the Spanish banking system, intertwined as it is with a real estate sector that is deeply in debt. The consequences of this relationship have been hugely negative for Spain’s economy and society.