

**From Boom to Bust:**  
**A Comparative Analysis of Greece and Spain under Austerity**

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Word Count: 8,654

**Abstract**

The deep economic crisis caused by the financial crisis and the austerity policies imposed thereafter have shaken the foundations of the Greek and Spanish political systems. Massive protests and demonstrations preceded the emergence of new parties that put an end to their stable bipartisan system. However, despite some general similarities, the economic and political consequences of the crisis have been substantially different in both countries. In Greece, a radical left party is in government and the economic situation does not appear to be improving. In Spain, there are some signs of recovery and the new challenger parties are different political animals. How can we explain such similarities and differences in the consequences of living under austerity in Greece and Spain? By comparing the experience of both countries, the chapter contends that the economic crisis in Southern Europe did not only lead to a political crisis, but that prior political developments also played a role in bringing about the economic crisis in the first place. In particular, irresponsible governments in Spain and Greece failed to regulate the pre-crisis boom effectively. Driven by incentives that derived from the ill-conceived institutional structure of the EU, they created a socio-economic environment, in which the economic crisis could only have the disruptive political consequences that we have witnessed. Consequently, the substantial differences in the restructuring of the party systems of both countries must be understood through a combination of pre-existing domestic conflicts and new conflicts that were brought about by the exceptional economic and political situation.

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## **Introduction**

The economic crisis in Greece has been mirrored by a crisis of the political system: not only has Greece experienced five elections in six years, but a technocratic government was installed by the European Union (EU) for six months and the traditionally bipartisan party system collapsed. Although the economic crisis has been the deepest in Greece, it has reshaped many spheres of life in all crisis-ridden countries, in particular the political system. In Italy a technocratic government under the leadership of Mario Monti replaced the Berlusconi government in November 2011. In Portugal anti-austerity parties won a majority in the 2015 elections and formed a coalition government, but their government has only has a small majority and remains unstable. Even in Ireland, which is often viewed as a poster child for austerity, the populist party *Sinn Fein* has dramatically gained in popularity and led large protests in 2014 and 2015 against new municipal water charges. Finally, in Spain the situation resembles that of Greece the closest: large-scale protests have swept across the country in response to the economic crises and two new parties, Podemos and Ciudadanos, have dramatically gained popular support, uprooting the previously stable bi-partisan party system.

In the context of the economic turmoil in the Eurozone, the political transformations in Greece and the other crisis-ridden countries are still ill understood (Hopkin 2015:163). This chapter attempts to analyze these transformations by comparing the experience of “living under austerity” in Greece and Spain. We argue that the consequences of the crisis cannot be understood independently of the social and political dynamics behind the crisis. Consequently, we attempt to link the consequences of the crisis to the political context of the countries in question and

argue that these political context before the crisis did not only contribute to the economic crisis but that they also structured the political consequences.

In both countries, Greece and Spain, the introduction of the Euro caused a large inflow of foreign credit, which left them vulnerable to external forces, when the financial crisis created a sudden stop of liquidity. The economic conditions for the crisis, however, were created by the political context. Importantly, both countries suffered from institutional degradation (Royo 2014) in the pre-crisis years that resulted in governments and regulators failing to prevent the pre-crisis boom. Clientelism and corruption allowed the Greek and Spanish elites to benefit disproportionately from the boom. Supported by entrenched interests that benefited from a dualized welfare system,<sup>1</sup> they had no incentive to “lean against the wind” and prevent the economic imbalances.

The windfalls from European integration tapered over the political dysfunctionalities in Greece and Spain, but the drying up of foreign resources meant that the state could no longer buy off its citizens through high economic growth. Consequently, a collapse of the political order followed the collapse of the economic order. Widespread dissatisfaction with the political system and a decline in support for traditional parties presented an opportunity for new challengers. Yet, the new challengers that emerged in both countries, and the resulting changes in the party system, were different. As the conflict between Greece and its creditors over austerity overshadowed all other political conflicts, traditional political forces remained at the heart of the political crisis in Greece. Eventually, Syriza, the main challenger party, became an ideological purifier on the left that replaced the former center-left

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<sup>1</sup> Dualized welfare systems benefit labor market insiders over outsiders, i.e. those individuals that are not in relatively secure, stable employment. This division is particularly strong in Southern Europe (see page 17-19 of this chapter).

Panhellenic Socialist Movement (PASOK). In Spain the new challenger parties have also tapped into the opposition to austerity and dissatisfaction with the European Union. However, the challenger parties have always emphasized their distinctiveness from the previous political order. While the pro- versus anti-austerity conflict came to dominate politics in Greece, we argue that in Spain this division between “old” and “new politics” is now mostly key for understanding political contestation.

The chapter proceeds in four steps. In the next section we analyze the economic dimension of the crisis. We review the dominant economic explanation for the crisis, compare the austerity measures that have been implemented in response in Greece and Spain, and assess the economic consequences in the two countries. Afterwards, we show that the crisis did not only result from the introduction of the Euro but that the political and economic context in Greece and Spain contributed to the unsustainable developments in both countries. In section 4 we build on this insight to analyze the political consequences. Distinguishing between a *behavioral* and *attitudinal* dimension of the political crisis, we show that there are striking similarities in Greece and Spain but that the consequences of economic meltdown have been conditioned by the domestic political context. In section 5 we conclude by way of outlining the implication of our argument.

## **The Economic Crisis in Greece and Spain**

### *The Economic Origins of the Crisis*

The economic origins of the crisis in Southern Europe have been analyzed in-depth. The story usually starts with the construction of the Euro, which was already criticized at its inception for forcing diverse national economies into a currency union

making economic management difficult (e.g. Bayoumi and Eichengreen 1997; for reviews see De Grauwe 2012 and Jonung et al. 2009). These problems became obvious at the turn of the century when the German economy was struggling and *The Economist* (1999) famously called Germany the “sick man of Europe,” while other countries in the Eurozone were booming. In response to this asymmetry of European business cycles, the ECB conducted a monetary policy that was neither appropriate for the German core nor for the booming periphery (De Grauwe and Ji 2014). It created pressures for divergence within the Eurozone and helped to build up large current account imbalances. Large export surpluses in the North were offset by deficits in the South, which were financed by credit that the North granted to the South (Hall 2012). The result was a large inflow of credit into both Greece and Spain, which increased the liabilities of both countries vis-à-vis non-residents (as represented by the financial account in figure 1).

--- Insert figure 1 about here ---

In Greece, the government mostly used this inflow of credit as an opportunity to expand government expenditure by borrowing from domestic and foreign banks. This was possible because financial markets had re-priced Southern Europe sovereign bonds and, hence, it became a lot cheaper for the Greek government to issue debt. For several consecutive years the government, thus, ran large fiscal deficits, increasing the amount of sovereign debt to 117.5 percent of GDP in 2009. But contrary to popular perceptions, this did not happen in Spain, where government debt remained relatively low. Instead, the ready availability of credit allowed the private-sector to go on a spending-binge: domestic banks leveraged their balance sheets by borrowing money

from Northern European banks in order to finance a mix of real-estate development and consumption in the early 2000s. This led to a huge boom in the Spanish construction sector similar to that in Ireland (Eichengreen 2012), which was also evident in employment figures: while more than a fifth of all Greek employees worked in the public sector (OECD 2015b), the Spanish construction sector employed nearly every fourth male employee (Fernández-Villaverde et al. 2013). In other words, unlike the Greek growth model, which was built on an expansion of the public sector, the Spanish growth model was built on an expansion of the construction sector.

Nevertheless, the consequences were similar. The large inflow of foreign capital left both countries exposed to an external shock. This external shock came in September 2008, when the financial conglomerate Lehman Brothers collapsed in the U.S. The resulting global credit crunch led to a “flight to safety” and a sudden stop of liquidity in Greece and Spain. The result can be described as a typical balance of payment crisis (Wolf 2011; Copelovitch, Frieden, and Walter 2016): the stop of liquidity burst the bubble in the construction sector in Spain and made it more difficult for Greece to finance its deficit on the capital markets. As investors lost trust in the ability of the Greek government to service its debt, the country had to turn to the EU and the International Monetary Fund (IMF) for bailouts in 2010, 2012, and most recently in 2015. Similarly, eventually the Spanish government could not control the crisis and, on behalf of its banks, it also applied for a bailout in 2012.

#### *The Economic Response to the Crisis*

Although the symptoms of the crisis were different in both countries, international policy-makers prescribed the same medicine. Building on the idea of “expansionary

fiscal contraction” (Alesina and Perotti 1997; Alesina and Ardagna 2010), the creditors insisted on structural reforms combined with a sharp reduction of government spending. With respect to Spain, this was a fundamental misdiagnosis of the crisis (De Grauwe 2013) because the Spanish crisis was not caused by government profligacy. However, creditors viewed Spain through the prism of Greece and condemned both countries to austerity, defined as the reduction in government spending during hard economic times.<sup>2</sup>

A detailed analysis of the memoranda of understanding in Greece and Spain is beyond the scope of this chapter, but it is useful to briefly compare them on a number of dimensions in order to understand their impact. In both countries, the international creditors pushed for austerity and structural reforms. Still, the Greek and Spanish governments both had already implemented reforms before they signed the memoranda of understandings. Greece came under pressure after the newly elected Prime Minister Papandreou revealed in October 2009 that the budget deficit would be a lot higher than previously predicted. Hence, financial markets became nervous and the credit rating agency Fitch Ratings first downgraded Greece on 8 December 2009 from A- to BBB+ (Oakley 2009).<sup>3</sup> Bowing to the pressure of the markets, Greece announced a first set of austerity measurements in February and March 2010 even before the government signed the Memorandum of Understanding on 3 May 2010. In the hope of regaining the confidence of investors, these measures included, for instance, an increase of the value added tax (VAT), a recruitment freeze in the public sector and cuts to government expenditure. In the absence of a credible commitment

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<sup>2</sup> For an account of the origins of austerity as an idea, see Blyth (2013).

<sup>3</sup> This was the first time in a decade that Greece did not have an A rating and reflected the worry in the financial markets about the sustainability of the Greek debt.

from a lender of last resort, however, these measures could not restore the confidence of investors.

Similarly, Spain reacted to the pressure of financial markets before the official bailout. In response to the 2008 financial crisis, the government had initially pursued a stimulus program and in 2011 the worst seemed over, when the Spanish economy grew again. However, the domestic banks were crippled by a large number of non-performing loans on their balance sheets, which forced the government to bail them out. In combination with the costs of the initial stimulus program, this increased the government's deficit and debt burden. In the context of the Greek crisis, international financial markets became increasingly worried about the size of the government's budget deficit and, starting in May 2010, Fitch downgraded Spain six times until the country lost its A rating in June 2012 (Fitch Ratings, 2012). Consequently, Spain introduced austerity measures in 2010 and 2011 in order to regain the trust of financial markets well before the government agreed to the Memorandum of Understanding on 27 July 2012. In 2011, the Spanish Socialist Workers' Party (PSOE) and the conservative People's Party (PP) even amended the Spanish Constitution requiring governments to cap deficits at 0.4 percent of GDP from 2020 onwards (Tremlett 2011).

The content of the programs introduced to combat the crisis were also similar in Spain and Greece. In Greece, for example, the terms of the first-bailout included cuts in public sector pay, additional increases in VAT and other taxes, as well as a limit on public investment and expenditure. In 2010 alone, the aim was to generate savings for a total amount of 2.5 percent of GDP and by 2014 the fiscal deficit was supposed to be reduced from 13.6 to below 3 percent of GDP (Memorandum of Economic and Financial Policies 2010). Additionally, the government also committed



itself to pursuing a large structural adjustment program that included the liberalization of closed professions and the reduction of employment protection. In the following years, creditors demanded that the Greek government intensified this program by abandoning the central wage bargaining system, dismissing 15,000 government employees and introducing a large privatization program.

In Spain, similarly, austerity measures were combined with a structural adjustment program. The government committed itself to increasing taxes and reducing government investment and expenditure, for example by a freeze on the pay of government employees. In June 2012 alone, Prime Minister Rajoy announced spending cuts and tax increases worth 65 billion Euro (Tremlett 2012) and, like in Greece, these measures included areas like healthcare and education. In terms of structural adjustments, the Spanish government implemented a labor reform in February 2012 that made it easier to lay-off workers and weakened the collective bargaining system. Moreover, the government pursued other reforms that resembled those in Greece, including cuts in social benefits, a raise of the retirement age and a privatization program to increase government revenue.

Despite these similarities between the austerity programs in Greece and Spain, there are also important differences. First, Spain's austerity program was shorter. Greece has remained in the spotlight of the crisis ever since October 2009 and it first implemented austerity measures in spring 2010. As the economic recession worsened, Greece was forced to pursue several further reform programs. In 2012 and 2015 it promised reforms in return for new bailouts and even in between the memoranda of understandings, the Greek government implemented additional austerity packages to satisfy the demands of the creditors. Spain also pursued initial reforms in 2010 and 2011, but the majority of measures were only announced in 2012, after the economy

had slid back into recession. Most importantly, Spain became the second country in the Eurozone to exit the bailout program again in January 2014 while an end to the Greek program is not in sight, yet.

Second, international creditors arguably put a lot more pressure on Greece to pursue austerity than on Spain. Delegates from the so-called “Troika” set up camp in Athens and became regular visitors in Greek ministries, but they were a lot less visible in Madrid. More importantly, the ECB was reluctant to act as a lender of last resort in response to the Greek crisis in 2010. But when the crisis had fully reached Spain (and Italy) in 2012, the ECB changed its approach. Fearing an implosion of the Euro, ECB President Mario Draghi (2012) famously promised to do “whatever it takes to preserve the Euro” in July 2012. This change of course was more successful in regaining the confidence of investors than any set of austerity measures could have been: within days, the borrowing costs of Spain and Greece decreased. Hence, Draghi’s announcement came just in time to take some pressure off the Spanish government by reducing the borrowing costs of the crisis countries and by supporting their ailing banking sectors.

Third, the austerity program pursued by the Spanish government was less severe than Greece’s program. Although a comparison between the size of different austerity packages is difficult, the structural balance can be used as a proxy for it because it excludes the impact of the economic cycle (e.g. through automatic stabilizers) and one-off measures (e.g. the sale of mobile phone license) on the government’s budget balance. Using this measurement as a basis for comparison, Greece’s balance improved by 20.3 percentage points from 2009 to 2014 percentage points, while the structural balance in Spain improved by 8.6 percentage points over the same time period (figure 2). This indicates that Greece pursued a lot more

austerity than the Spanish — in fact, Greece had to endure the deepest austerity package of all crisis-ridden countries according to this measurement. Still, the austerity programs created large economic dislocations in both Greece and Spain.

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### *The Consequences of the Crisis*

Greece experienced by far the deepest economic downturn of all countries in Europe. It was in recession from 2008 to and 2013 when real GDP fell by 26.0 percent (Eurostat, 2015). In contrast, the Spanish had a relatively strong recovery after the global financial meltdown had dragged it into an economic slump from 2008 to 2010. In 2012, Spain slipped back into recession, though, and overall Spanish real GDP fell by 7.3 percent from 2008 to 2013 (Eurostat 2015b).<sup>4</sup> This fall in economic activity in Greece and Spain created similar levels of unemployment in both countries (figure 3a) but unemployment before the crisis was higher in Spain than in Greece. In Greece unemployment increased from 7.2 percent in July 2008 to its peak of 27.9 percent in January 2014; in Spain it increased from 11.2 percent to 25.9 percent over the same time period. These levels of unemployment were not only dramatically higher than in Northern Europe, but they were also a lot higher than in the rest of the crisis-ridden South. Still, the true damage of unemployment is evident from the high levels of youth unemployment: in both countries the share of unemployed under the age of twenty-five tripled between 2007 and 2013 (figure 3b), reaching 60 percent in Greece and 56.9 percent in Spain (Eurostat 2015a). Consequently, the crisis hit some of the

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<sup>4</sup> In 2014, both countries returned to growth again, but in 2015 the economic paths of Greece and Spain diverged again (Eurostat 2015d). While the economic uncertainty after the election of Syriza in January 2015 had an adverse economic impact, relatively high growth is predicted for Spain in 2015 (IMF 2015b).

most vulnerable people in society as young labor market participants and low-skilled workers were the first ones to loose their jobs.

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However, even many people who retained their jobs were a lot worse off as a consequence of the crisis because, on average, the wages of employees fell in both Greece and Spain. In Greece, this fall was particularly large: from 2009 to 2014, the average real wage fell by nearly 24 percent in Greece, while the average annual real wage fell by 7 percent in Spain (OECD.Stat 2015). This contributed to a low level of domestic consumption, but it also increased poverty and social inclusion. In 2014, 36 percent and 29 percent of the entire population was at risk of poverty or social exclusion in Greece and Spain, respectively (Eurostat 2015e). Compared to 2007 this figure increased by more than 25 percent in both countries and, consequently, inequality also increased during the crisis according to various measures. While the Gini coefficient rose from 33.4 in 2008 to 34.5 in 2014 in Greece, it rose from 31.9 in 2008 to 34.7 in 2014 in Spain (table 1).<sup>5</sup> Similarly, the income of workers at the 90<sup>th</sup> percentile (individuals earning more than the bottom 90 percent of the population) compared to the earning of workers at the 10<sup>th</sup> percentile (individuals earning higher than the bottom 10 percent) increased in Greece and Spain by 20 and 18 percent, respectively (Eurostat 2015c).

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<sup>5</sup> In Spain the Gini coefficient actually peaked in 2012, when it reached 34.2.

Hence, the social dislocations of the crisis have been large in both countries and the pains of the economic adjustment were not shared equally across society. The crisis produced a large group of people who were left unemployed, received few social benefits and suffered from the decreasing quality of public services in health and education (Matthijs 2014). At the same time, austerity policies have not even had the desired effect on government finances. In both countries, the government debt in 2015 was significantly larger than at the beginning of the crisis and the deficits remained outside the 3 percent limit specified by the Stability and Growth Pact. Especially in Greece, this is a function of the large fall in GDP. Given that the debt burden of a country is measured relatively to GDP, the debt-to-GDP ratio can increase due a fall in the denominator (GDP) even when the numerator (debt) stays constant (Blyth 2013). Consequently, the crisis has shown that the deflationary impact of austerity policies makes it extremely difficult for these policies to have the desired effect of reducing debt. As Olivier Blanchard, the former Chief Economist of the IMF, admits in a co-authored paper, economists had underestimated the fiscal multiplier when predicting the impact austerity policies (Blanchard and Leigh 2013).

The data for Greece and Spain supports this conclusion. Even though the fall in GDP was a lot higher in Greece compared to Spain and any other European country, Greece is no exception when it comes to results of the attempted economic reforms. While Spain has fared better than Greece during the crisis, it is no poster child for austerity either.<sup>6</sup> In fact, a comparison with Greece needs to take into account that the original crisis in Greece was not only a lot deeper than the crisis in Spain, but that the path of adjustment was also a lot more difficult for Greece due to a

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<sup>6</sup> In the wake of the Greek referendum many commentators have claimed that austerity has worked elsewhere. For example, the Council of Economic Experts in Germany (Bofinger et al. 2015:1) claimed that “Ireland, Portugal, and Spain all successfully completed their program” and that “the economic situation has markedly improved.”

more ambitious reform program, as shown above. Moreover, politicians and commentators have consistently and deliberately overstated the positive trajectory of Spain,<sup>7</sup> but the average citizen still feels the hangover after the party, as we show below. Consequently, Spain has not recovered faster than Greece because of austerity but despite of it.

### **The Political Origins of the Economic Crisis in Spain and Greece**

The comparison between Spain and Greece shows that the origins and the consequences of crisis in Greece have indeed been systemic. Although the details are different, there are many patterns in the economic crisis that have played out in a similar manner in both countries. With the benefit of hindsight it is, therefore, easy to argue that there were structural problems with the Eurozone (Eichengreen 2012). Yet, this begs the question why politicians and regulators allowed the structural problems to persist in the run-up to the crisis. Much of the existing literature focuses on the economic and financial origins of the crisis and largely ignores the political and social foundation of markets (Polanyi 2001 [1944]). But in order to comprehend the consequences of the economic meltdown completely, we need a comprehensive understanding of the crisis, which includes the social and political dynamics behind it.

Matthijs and Blyth (2015) have come a long way in addressing this shortcoming of the literature. They focus on the transnational bargains that are at the heart of the Euro and argue effectively that the euro's lack of embeddedness in proper European institutions is at heart of the current crisis: not only did the Euro lack a

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<sup>7</sup> Fearing punishment from voters and capital markets, politicians have done this deliberately. For instance, Prime Minister Rajoy claimed in a state of the union address that "Spain has passed from being a country on the brink of bankruptcy to a model of recovery that provides an example to other countries in the EU" (Buck 2015).

proper financial (Jones 2015) and fiscal union (Jabko 2015) but also a political union that could create democratic legitimacy (Schmidt 2015). However, on the domestic levels these institutions existed. For example, the member states of the Eurozone possessed the necessary tools to regulate the banking sector, as Hansen and Gordon (2014) point out. Why did they not use them?

### *Clientelism and Corruption*

In the absence of effective European institutions, the burden to counteract the growing imbalances in Europe was on domestic institutions. Yet, this burden was placed largely on the shoulders of countries that were least able to do it. First, Greece and Spain both have a weakly institutionalized party system. As democratic latecomers, the party systems were formed when the level of socio-economic development had already been relative high (Hopkin 2001) and, consequently, the party systems are weakly anchored in civil society. As a response, parties formed a cartel to obtain resources from the state (Katz and Mair 1995; Katz and Mair 2009), which they did “either through mass party clientelism and corrupt use of public office to raise money, or through the state funding of parties” (Hopkin 2002, 10). This weakened the patterns of partisanship even further and contributed to the prevalence of informal politics in Southern Europe.

In Greece, two parties dominated the political system before the electoral crisis: New Democracy (ND) and PASOK. ND governed Greece’s new democracy in the 1970s, but PASOK came to power with a landslide victory in 1981. Initially PASOK supported radical left-wing policies, including an exit from the European Economic Community, but quickly the party renounced its most extreme positions and shifted towards the center. In programmatic terms, some differences between ND

and PASOK continued to exist, but they paled in comparison to the way these two parties conducted themselves when they were in power: both parties used the state resources to give out favors in return for electoral support (Featherstone 2011). As a result, both parties welcomed the cheap access to credit following Eurozone membership: real government consumption increased by nearly 30 percent from 1995 to 2005, when PASOK was in power, while it increased by 17 percent from 2004 to 2009, when ND was in power (Eurostat 2015c). Consequently, it was not in the interest of Greek politicians to prevent the increasing imbalances in the Greek economy in the early 2000s. Rather, they fed off them and used them to entrench their position in society.

In Spain, the government did not play the same role and the situation is less clear-cut. Moreover, Hopkin (2001) is certainly right that the notion of a clientelistic “Southern model” should be treated with caution. Still, there is also clear evidence of crony capitalism in Spain, much of which was revealed after the outburst of the crisis (Royo 2014, 1574). Contrary to Greece, where the clientelistic networks were mostly centralized at the national level, the regional and local authorities played a more important role in the case of Spain after the administrative and political decentralization in the early 2000s (Hopkin 2012). Eventually, the political decentralization “led to the emergence of regional, local elites that took over the local and regional institutions, including the *cajas*, whose boards were quickly filled with political appointees who used their position for their own personal gain and/or as a clientelist instrument to finance their projects” (Royo 2014, 1574).<sup>8</sup> The rapid expansion of the construction sector facilitated by privatization processes, thus,

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<sup>8</sup> Cajas are the Spanish saving banks. Many of them were involved in financing the real-estate booms and, as a consequence of the crisis, had to be rescued by government bailouts.



increased the opportunities for favoritism mostly at the regional and local levels.<sup>9</sup> Most importantly, the distribution of public contracts for infrastructure projects allowed politicians to generate financial and public resources.

Although initially parties tried to blame individual politicians for this behavior, the problem was more endemic. Molinas (2012; 2013) argued that an extractive political class had developed in Spain due to institutional arrangements agreed during the transition to democracy. For instance, proportional representation and blocked party lists consolidated a weakly institutionalized party system, which the political class used to collude with economic elites in order to extract resources from society. As in Greece, they formed a powerful set of interests that was able to resist reforms that would have prevented the increasing imbalances in the Spanish economy.

#### *Dualization and Elite Insulation*

As Royo (2014) argues, however, the problem was not one of extractive elites only. Instead other vested interests prevented the government from pursuing reforms that would have reduced the dependency of Greece and Spain on foreign credit. Importantly, the benefits of the welfare state across most of Southern Europe are geared towards providing benefits to particular political constituencies (Ferrera 1996; 2005; Rhodes 1997). As Beramendi et al. (2015, 395) show, the Southern European welfare states are characterized by weak social investment policies and “particularistic, often residual and regressive social policies of consumption.” In particular, the pension systems are expensive due to high replacement rates and high employment protection legislation has contributed to a dualized labor market pitting

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<sup>9</sup> This process was even supported by the benefits of membership in the European Monetary Union. Funds from the EU’s Convergence and Cohesion Funds allowed the public sector to finance new railway stations, highways and airports across the country (Hopkin 2012).

organized insiders against an increasing amount of outsiders, who do not benefit from this legislation (Rueda 2007). Before the crisis this created an institutional bias against reform: vested interests had captured the welfare state and were unwilling to forego these benefits.

The protection of insiders came at the expense of the outsiders, but the economic windfalls from European integration helped to taper over the tensions. In Spain the boom in the construction sector created opportunities for employment for low-skilled employees, while the Greek government itself expanded employment and distributed resources through greater government consumption. Contributing to high growth rates, this helped to spread the benefits of Euro membership through society and weakened demands for reforms from outsiders. Thereby, European integration entrenched the existing structural problems and weakened the demand for economic reforms.<sup>10</sup> It insulated elites from political pressures and helped to sustain informal politics within Spain and Greece (Warner 2007). Politicians were able to continuously use the resources of the state to their own benefit without being held accountable by civil society (Royo 2014).

The lack of reform made things worse. Neither in Greece nor in Spain opportunities for productivity increasing investments were created and, hence, foreign direct investment did not unlock the key to sustainable economic growth. Instead, the excesses in the public sector (in Greece) or the non-tradable sector (in Spain) spurred the pre-crisis growth. In other words, there was a vicious cycle: the existing institutional power structure created unsustainable economic growth, which in turn entrenched the institutional power structure further. Consequently, this power

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<sup>10</sup> This happened analogously to the lack of reform pressures from financial markets identified above (see Fernández-Villaverde et al. 2013, 146).

structure did not only contribute to the crisis, but it also determined how the economic crisis played out in the two countries.

## **The Political Consequences of the Economic Crisis**

### *The Attitudinal Dimension: A Widespread Political Malaise?*

It can be expected that an economic shock with such social repercussions will trigger a political reaction from those affected. This reaction was expressed on both *attitudinal* (lack of confidence in political institutions and the political system) and *behavioral* (protests, electoral volatility and collapse of party systems) dimensions (Kriesi 2015). For the first dimension, indicators of political trust towards the key representative national and European political institutions, as well as those of the levels of satisfaction with democracy, are particularly revealing. Since the beginning of the economic crisis in September 2008, as marked by the vertical dotted line in our figures, they followed a remarkably similar pattern in both countries. The average of satisfaction with the way democracy works in the national country and the average satisfaction with the way democracy works in the EU (figure 4) decreased substantially after 2008 in Greece and Spain, reaching some of the lowest levels recorded since the transition to democracy in both countries.<sup>11</sup>

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<sup>11</sup> Respondents are asked the following two questions: “On the whole, are you very satisfied, fairly satisfied, not very satisfied or not at all satisfied with the way democracy works in (OUR COUNTRY)?” and “How about the way democracy works in the EU?” We recoded the answer categories, which now range from four to one: 4 = “Very satisfied”; 3 = “Fairly satisfied”; 2 = “Not very satisfied”; 1 = “Not at all satisfied”. The patterns from this data are confirmed by other data. For a historical trend since 1985, see <http://www.pop.pt/en/graph/politics/satisfaction-with-democracy/el-es/?colors=es-2%7Cel-1>.

Mistrust towards the national government, parliament, and political parties (figure 5), followed an almost identical trend.<sup>12</sup> Although in both countries mistrust towards political parties had been considerably lower than towards parliament and government before the crisis, we observe that the levels converged to another historical low during it. Compared to the levels of trust towards government and parliament prior to 2008, the decrease is nothing less than spectacular: while more than 50 percent of respondents trusted the national parliament before the crisis, less than 10 percent of respondents trusted the national parliament at the height of the crisis.<sup>13</sup> European political institutions also did not go unpunished. In fact, figure 6 illustrates that European institutions suffered the largest average drop in trust in Greece and Spain compared to all other institutions. In 2015 there was a slight recovery in these attitudes, but the average levels in both countries remain far from the averages prior to the crisis.

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Although some studies have shown a strong correlation between the drop in trust in political institutions and macroeconomic indicators, particularly with unemployment (Roth, Nowak-Lehmann D., and Otter 2013), the widespread political malaise can hardly be attributed solely to economic explanations. Applying the classic literature of economic voting whereby voters punish or reward incumbent governments depending

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<sup>12</sup> Respondents are asked the following question: "I would like to ask you a question about how much trust you have in certain institutions. For each of the following institutions, please tell me if you tend to trust it or tend not to trust it." We recoded the answer categories, which now range from zero to one: 1 = "Tend to trust"; 2 = "Tend not to trust."

<sup>13</sup> The recovery of trust in 2015 in the case of Greece is likely due to the victory of SYRIZA in the January legislative elections of 2015. As part of the classic reward-punish mechanisms in democracies, elections tend to momentarily increase trust towards institutions. However, it remains to be seen if trust levels remain high after Tsipras' acceptance of the conditions of a third 86 billion Euro bailout on July 12. The last Eurobarometer survey included in our dataset is from March 2015.

on the macroeconomic performance, it would be expected that levels of trust towards the incumbent government would have decreased as citizens would blame it for its “bad” management of the economy. If this were the case, however, trust should recover after citizens are given the opportunity to reward or punish political parties for their performance in government (Key and Cummings 1966). However, this is not what is observed in the data. “The cumulated effect of the Great Recession, goes far beyond the short-term punishment of incumbents” (Hernández and Kriesi 2015, 19) and mistrust is indiscriminately projected towards both national and European political institutions, regardless of elections and changes of governments. This suggests a far deeper political malaise than discontent with the incumbent’s performance. A simple reward-punishment mechanism based on the performance of the economy, thus, cannot explain the indiscriminate dissatisfaction with the political system in Greece and Spain because it sheds little light on the exceptional situation that both countries faced. What happens when programmatic competition between parties declines (Roberts 2013) or when mainstream parties are increasingly perceived as lacking “responsiveness” altogether (Mair 2009)? How do citizens react when they are faced with a “democracy without choices” (Bosco and Verney 2012)?

Although these scholars use different terms, the diagnosis remains the same: mainstream parties, regardless of their ideology, were strongly constrained in economic policy, leading to a situation where voters could not perceive any significant differences between the parties anymore. As a result, large sections of society did not feel politically represented and stopped trusting political institutions, often considered an essential feature for the effective functioning of representative democracy (Gamson 1968). Therefore, the political context, especially the clarity of responsibility and the clarity of alternatives (Hobolt and Tilley 2014; 2011; Anderson

2000; Powell and Whitten 1993), is key for comprehending the attitudinal dimension of the political crisis. The lack of political alternatives that accompanied the austerity programs, we argue, triggered widespread disenchantment with the political systems of Greece and Spain. Additionally, the lack of a clear responsible actor for the deteriorating socioeconomic conditions made things worse and created a political crisis or crisis of representation similar to the one that many Latin American countries experienced in the 1980 and 1990s, where the introduction of similar neoliberal oriented reforms produced an analogous distortion of party systems (Roberts 2013; Mainwaring 2006). The attitudinal dimension of the crisis is, thus, intrinsically intertwined and cannot be understood separately from the behavioral dimension.

*The Behavioral Dimension: From the Streets to the Institutions*

The attitudinal expressions of the political crisis in both Greece and Spain eventually translated into a behavioral dimension, which manifested itself in both *contentious* (protests) and *conventional* (electoral punishment and new parties) politics. In the electoral arena, this took the form of a two-step process in both countries, as shown in tables 2 and 3. In the first post-crisis elections, the incumbent lost to the mainstream challenger party (ND to PASOK in 2009 and PSOE to PP in 2011). In a second step, new challenger parties gained a significant share of the votes (2012 and 2015 in Greece and 2015 in Spain).

--- Insert Table 2 and 3 about here ---

However, while this two step process was similar in the two countries, and while the attitudinal expressions described above were also similar in both countries, there are significant differences in the behavioral dimension of the crisis that are worth stressing. In particular, the mobilization in the streets, the transformations of the party systems, and the nature of the new challenger parties were tellingly different.

In Spain the mass demonstrations that would give the name to the 15-M movement —and that would later trigger similar protest in the US under the “we are the 99% banner” (Castañeda 2012)— were initially convened by a small online platform called “Democracia Real Ya!” (Real Democracy Now!) in May 2011. With a simple, direct and nonpartisan message Spanish people mobilized both inside and outside Spain. “We want more democracy!”, “We are not commodities of bankers and politicians!”, or “They do not represent us!” became some of the slogans that were coined by the movement. The so-called “Indignados” were able to connect with large sections of the population despite (or perhaps because) the fact that they refused any involvement with traditionally politicized organizations such as labor unions or youth organizations of parties. More than just anti-austerity protests, the movement had to do with providing “time and space for every participant to express themselves and take an active part in the camp and movement organization, notably through long group discussions and the creation of commissions and working groups around specific issues” (Kaldor and Selchow 2015:206).

The causes of contention that sparked the movement were rooted in the perception that an extractive and corrupt elite had governed unaccountably and made the citizens pay for a crisis that they had not caused. Whereas austerity was an important mobilizing factor for the protests, the movement also repeatedly identified

the political structure of the country as one of the main problems (Calvo, Gómez-Pastrana, and Mena 2011a). The idea of “new” politics grew as an alternative to “old” or “traditional” politics, which, to the movement, was represented by the extractive economic and political elites. At the core of this idea were participatory mechanisms and claims for more direct democracy, with the use of the internet and social media being its main driver (Hughes 2011). The Indignados movement was, therefore, not solely an anti-austerity protest movement, but also a much wider expression of the dissatisfaction with the Spanish political system. In fact, it was the inception of this new conflict in Spanish politics that would later be expressed with the emergence of new parties like Podemos and even Ciudadanos, as explained below.

Although the so-called “Greek Indignados” also played a role in the anti-austerity protests from 2010 to 2012, they were neither the only actor nor the most important one. In fact, anarchists, social justice groups, educational groups and youth organizations, but especially political parties and labor unions (from the private and public sector), were equally if not more important —depending on the individual protest— in participating and organizing the protests. For instance, both the confederation of trade unions (GSEE) and the central union of civil servants (ADEDY), as well as the youth organizations of the communist party KKE, SYRIZA and ANTARSYA, played a key role in the organization of several major protests in the country (Kanellopoulos and Kostopoulos 2014).

One of the main differences between the way in which anti-austerity protests organized and developed in Spain and Greece —which is particularly important to understand the political consequences and the characteristics of new parties— is precisely that the Indignados in Spain “mainly involved young and highly educated people not connected with “old” political actors like trade unions and political parties”



(Karyotis and Rüdig 2015: 496). This difference is central for explaining how these movements translated into the conventional political arena and the nature of the new challengers.

*The new challengers: A populist left?*

The strong dissatisfaction with traditional parties opened an exceptional opportunity for new political entrepreneurs to capitalize on the political crisis. The traditional social democratic parties in both countries faced an irreconcilable dilemma that would ease the emergence of new parties on the left. This dilemma, framed by Mair (2009) as responsibility versus responsiveness, describes the situation confronted by both PSOE and PASOK. Both had to introduce measures contrary to their ideology — whether through changes in the constitution or the implementation of cuts on welfare— in order to behave “responsibly” and satisfy the demands of the international creditors. This came at the cost of “responsiveness” to the ideological foundations of these parties.

In Greece, this implied the near disappearance of PASOK, going from 43.9 percent of the vote in 2009 to 4.7 percent in 2015. By implementing austerity after its election in 2009, the party had not only committed an ideological somersault, but by depleting the resources available to distribute, it had also undermined the clientelistic linkages that the party depended on (Afonso, Zartaloudis, and Papadopoulos 2014). The Coalition of the Radical Left SYRIZA benefited the most from this decline of PASOK, going from 4.6 percent in 2009 to winning both elections in 2015 with over 35 percent of the votes. Not only most of SYRIZA’s votes came from PASOK, but even some politicians themselves would change affiliation to the new party. As PASOK lost the credibility to stand up to the European creditors and to implement a

leftist program, SYRIZA became PASOK's "ideological purifier", a particular type of challenger party that is successful when established parties are forced to change their position with regards to salient lines of conflict (Lucardie 2000). With a radical leftist and anti-austerity agenda, the party promised to be "responsive" towards the electorate by standing up to the international creditors demands and putting an end to austerity, while at the same time combating the domestic oligarchy. Thus, SYRIZA confronted both the domestic and the European elites, dubbed as the internal and the external Troika.

Similarly, in Spain the initial challenger party that emerged from the Indignados movement was Podemos, which became the third biggest party in the 2015 election winning nearly 21 percent of the vote. Although both SYRIZA and Podemos have been labeled as parties of the new "populist left" in Southern Europe, and despite the visible links between both parties,<sup>14</sup> there are significant differences that suggest that they are two different animals. Most visibly, SYRIZA was presented as a clear alternative from the left and had a long political tradition, despite its weak parliamentary representation in the past. In contrast, Podemos was a completely new party, which, in line with the ideas of inclusiveness of the 15-M movement, shed traditional left-right ideological labels. A more analogous situation would have been for the United Left (IU) in Spain, a traditional leftist party with a clear anti-austerity message, to "purify" PSOE, just as SYRIZA did with PASOK. Why did this not happen? Why did it take a new party such as Podemos to capitalize on the emerging protest vote?

The electoral arenas of politics in Greece and Spain were closely influenced by developments in the arena of contentious politics. Whereas in Greece the anti-

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<sup>14</sup> On January 22, 2015, for instance, Alexis Tsipras symbolically invited Pablo Iglesias, the leader of Podemos, to the end-of-campaign meeting before the elections.

austerity discourse was one of the key issues in all the demonstrations, which was the political territory of the left, this was not so clear in the case of Spain. As explained above, the Indignados emerged as an all-encompassing movement that persistently claimed to be inclusive to all citizens regardless of their ideology, pursuing the idea of “new” politics. Thus, the issue of “new” politics, including corruption and the opposition to the domestic political system, became salient in Spain in both the contentious and conventional arena of politics while the intervention of external European actors in domestic politics did not play a determining role as much as it did in Greece. In fact, Calvo, Gómez-Pastrana, and Mena (2011b) show that the most important objectives of the 15-M movement were the fight against corruption and the reform of the electoral system. Therefore, Europe and the enforcement of austerity played a smaller role in re-shaping the Spanish political system than that of Greece.

The greater importance of domestic renewal over European anti-austerity issues also explains the strong rise of a “new” politics right-wing party in Spain, Ciudadanos, which has gained rapid electoral support since the last regional elections in 2015.<sup>15</sup> Despite being a “pro-austerity” party, it entered the conventional political arena as the right wing equivalent of Podemos, which also challenged the domestic elites but had little to say about Europe. Although Ciudadanos self-defines as a liberal party with a very different program than Podemos, their voters share a set of characteristics that place both parties in direct competition with each other on this new dimension of conflict despite being on different sides of the ideological spectrum. Compared to the voters of PP and PSOS, voters for both parties are more concerned with the political situation and are more likely to be young and from urban areas (Vidal 2016), indicating a new dimension of political conflict in Spain.

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<sup>15</sup> Although there is a similar new party in Greece, To Potami (The River), it only obtained 4 percent of the votes in September 2015 and 6 percent in January of the same year.

This new dimension of conflict in Spain also explains why it would take a new party such as Podemos to capitalize on the emerging protest vote. Although the traditional left party IU had long campaigned against austerity, it did not correspond with the idea conveyed in the contentious political arena about the necessity of “new” politics and was, thus, not able to capitalize on the emerging protest vote. Being perceived as part of the “old” politics weighted heavily among young and urban voters, who were demanding a change in political culture. Conversely, the dominance of the new dimension of conflict in Spanish politics can also account for failure of Podemos to “purify” PSOE. While the difference in the depth of austerity (and, thus, the degree of “ideological betrayal”) that the social democratic parties were forced to implement is also important for explaining the extent that voters and politicians switched, it is only one part of the story. Importantly, many “old” political forces, including the trade unions, remained loyal to PSOE because they also felt threatened by the rise of the new challenger parties in Spain. In contrast to Greece, the new challenger parties have not (yet) been able to win the support of these actors, creating a deep division between “old” vs. “new” politics among voters and elites.

Consequently, the political developments of Greece and Spain in the eve of the Great Recession resemble each other, but there are important differences that explain the diverging patterns in the shaping of the new structure of conflict. This restructuring of the party systems in both countries was different because the main challenger in each country responded to different patterns in the contentious arena, which led to a different institutionalization of conflicts.<sup>16</sup> Due to the intensity of the crisis, the conflict about austerity dominated in Greece, while a conflict between “old”

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<sup>16</sup> Although the leaders of Podemos speak of overcoming the left-right spectrum in order to attract voters regardless of their ideological position, studies have shown that citizens persistently place the party on the very left of the ideological scale (Fernández-Albertos 2015).

and “new” politics became more prominent in Spain. In other words, the domestic dimension prevailed in Spain, whereas in Greece the European dimension added to the former. Naturally, these new conflicts are deeply intertwined with other idiosyncratic conflicts in each country. For instance, the rise and success of Ciudadanos cannot be understood without the territorial conflict in Spain because the issue of independence for Catalonia is key to their program (Rodríguez Teruel and Barrio 2015). Although a full discussion of these issues is beyond the scope of this chapter, it is important to note that the domestic political culture of countries is essential for understanding the new political conflicts in Greece and Spain.

In sum, the political consequences for both countries were similar in attitudinal terms but different in behavioral terms. In the attitudinal dimension, we observed a similar generalized political malaise that cannot be understood without taking into account the exceptionality of the political context. The decline of programmatic competition between the main parties of both countries and the lack of immediate political alternatives led to a broad disenchantment with the political system. In the behavioral dimension, on the contrary, we observed some clear differences: the way the economic crisis development and the extent to which austerity was introduced shaped the reaction in the contentious arena and gave salience to different political conflicts. This also led to different patterns of party competition and different types of challenger parties.

## **Conclusion**

The response to the economic crisis in Europe has been driven by neo-classical economic theory. Policy-makers have attempted to turn the South into the North in

order to create the optimal currency area that Europe has never been. However, in this chapter we have argued that the crisis was the introduction of the Euro is not exclusively to blame for the crisis and the resulting imbalances in Europe. Instead, prior political dynamics also played an important role. The cases of Spain and Greece are tellingly similar in that respect: both countries suffered a period of institutional degradation (Royo 2014), where governments and regulators failed to prevent the pre-crisis boom. Clientelism and corruption, in its different levels and forms, allowed the Greek and Spanish elites to extract resources and benefit from the pre-crisis boom disproportionality. In combination with the support from entrenched interests that benefited from the dualized welfare system, this des-incentivized regulation that would have controlled the excesses in the public sector (in the case of Greece) and the private sector (in the case of Spain).

In the pre-crisis era the economic windfalls of European were large enough to shield the political system from domestic opposition, but the political dysfunctions of Greece and Spain were exposed in the last few years. In the wake of the crisis, the trust towards national and European political institutions dropped dramatically as citizens became increasingly dissatisfied with the political system. This dissatisfaction was not only rooted in the declining performance of the economy, but also in the political context, that is, the clarity of responsibility and the availability of alternatives. The result was an attitudinal crisis that was similar in Greece and Spain, but which evolved into two distinct behavioral patterns in the two countries.

In Greece, the austerity programs were so harsh and comprehensive that they overshadowed every other political issue. Thus, the international creditors, personified by German politicians and bureaucrats of the Troika, were quickly regarded as the

main culprit for the economic situation in Greece and, as a result, the main conflict in Greek politics became one that posed domestic political actors against international actors (and their domestic allies). In Spain, in contrast, the political crisis played out differently. The austerity program in Spain was not only less deep but the European institutions did not have the same (perceived) involvement in its design. While the austerity policies were also politically divisive, the main political conflict in Spain became an internal one: political forces, who stood for “old” or “traditional” politics, were attacked by new protest movements and political parties, which were supporting a form of “new” politics centered around claims for participatory mechanisms and more direct democracy.

The new political parties that have emerged out of these conflicts are representative of these patterns and, despite their common stance against austerity, Syriza and Podemos are different political animals. These differences are best explained by the developments in the contentious arena of both countries, which created the political opportunities for the new challengers. Whereas in Greece it was the traditional left that capitalized on the emerging discontent, it took a new party that shunned ideological labels in Spain to do so. Therefore, the behavioral consequences of the crisis were different because of a combination of preexisting domestic grievances and new conflicts that were brought about by an exceptional economic and political situation.

Still, the economic crisis created a radical transformation of domestic politics in both Greece and Spain that is far from over. In Greece, the political system is once again dominated by two political parties, the conservative ND on the right and the governing party Syriza on the left. In 2015, the latter signed a third Memorandum of Understanding including further austerity and reforms without the guarantee of much

a needed debt relief. The political scenario is, thus, still subject to further changes that might, in the worst-case scenario, further increase the support for the neo-Nazi party Golden Dawn.<sup>17</sup> Although the economic situation of Spain seems less gloomy than in Greece, the political scenario also remains highly volatile. After the rise of the two challenger parties Podemos and Ciudadanos, the elections in December 2015 were not conclusive and after several months of negotiations the political parties failed to form a government. Therefore, at the time of writing, the political future in Spain is less certain than ever and the outcome of the new elections in June 2016 cannot be predicted. Moreover, the future government will have to deal with further budgetary cuts demanded by the European Commission. Therefore, none of the two countries, and by extension the Eurozone as a whole, have made it out of the woods. Overall, the political consequences of the crisis in Southern Europe have already been colossal, but they might have only been the prelude of what is still to come.

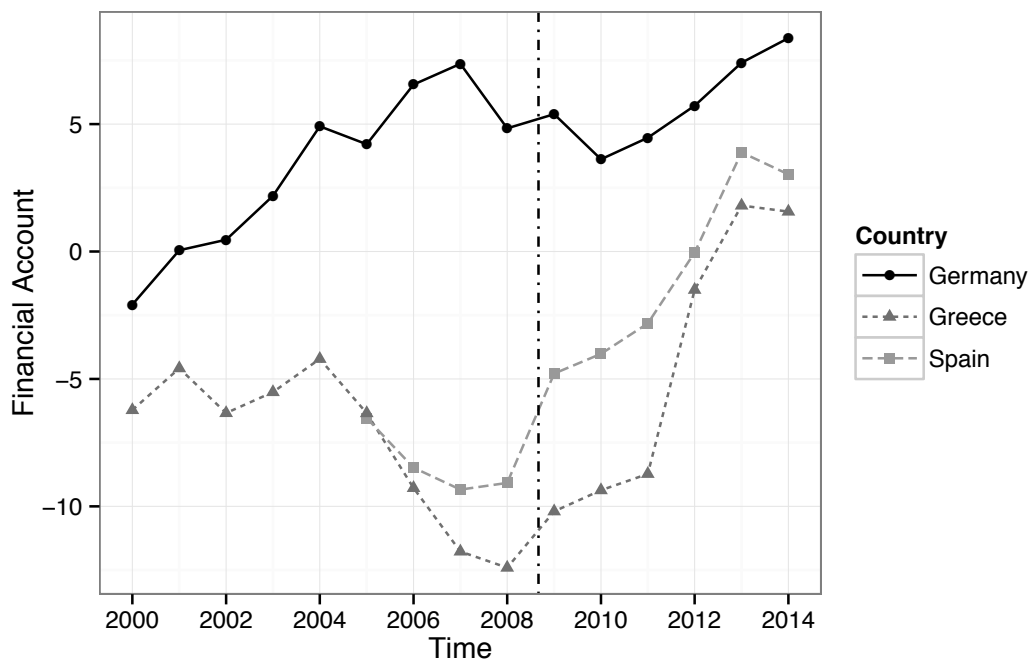
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<sup>17</sup> In the September 2015 elections it was already the third most voted party in the 2015.



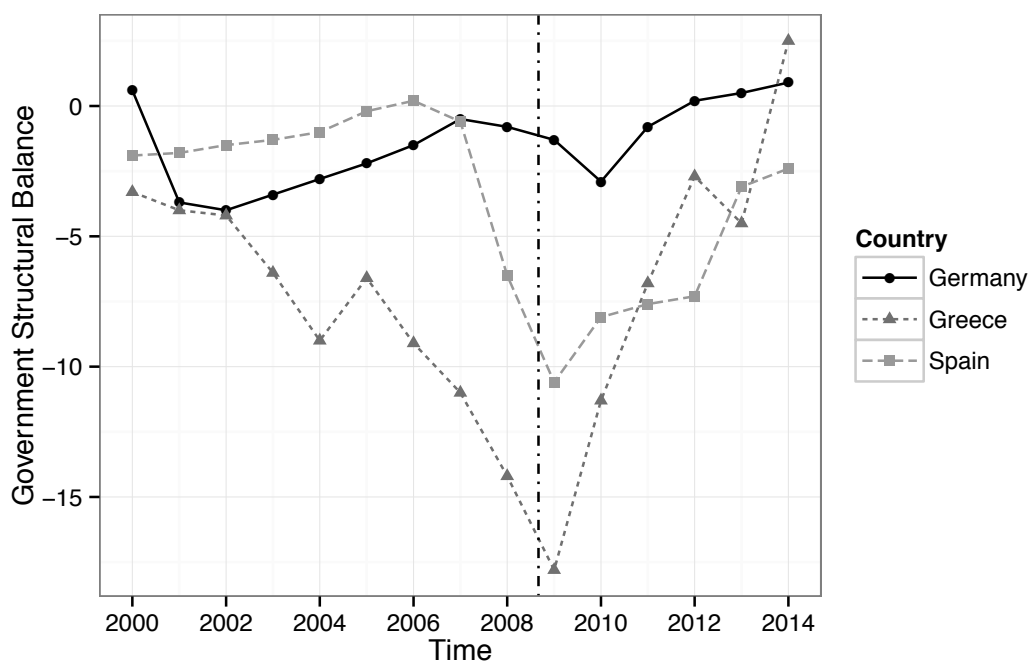
## Figures

Figure 1: Financial Account as a Percentage of GDP of Germany, Greece, and Spain, 2000 - 2015



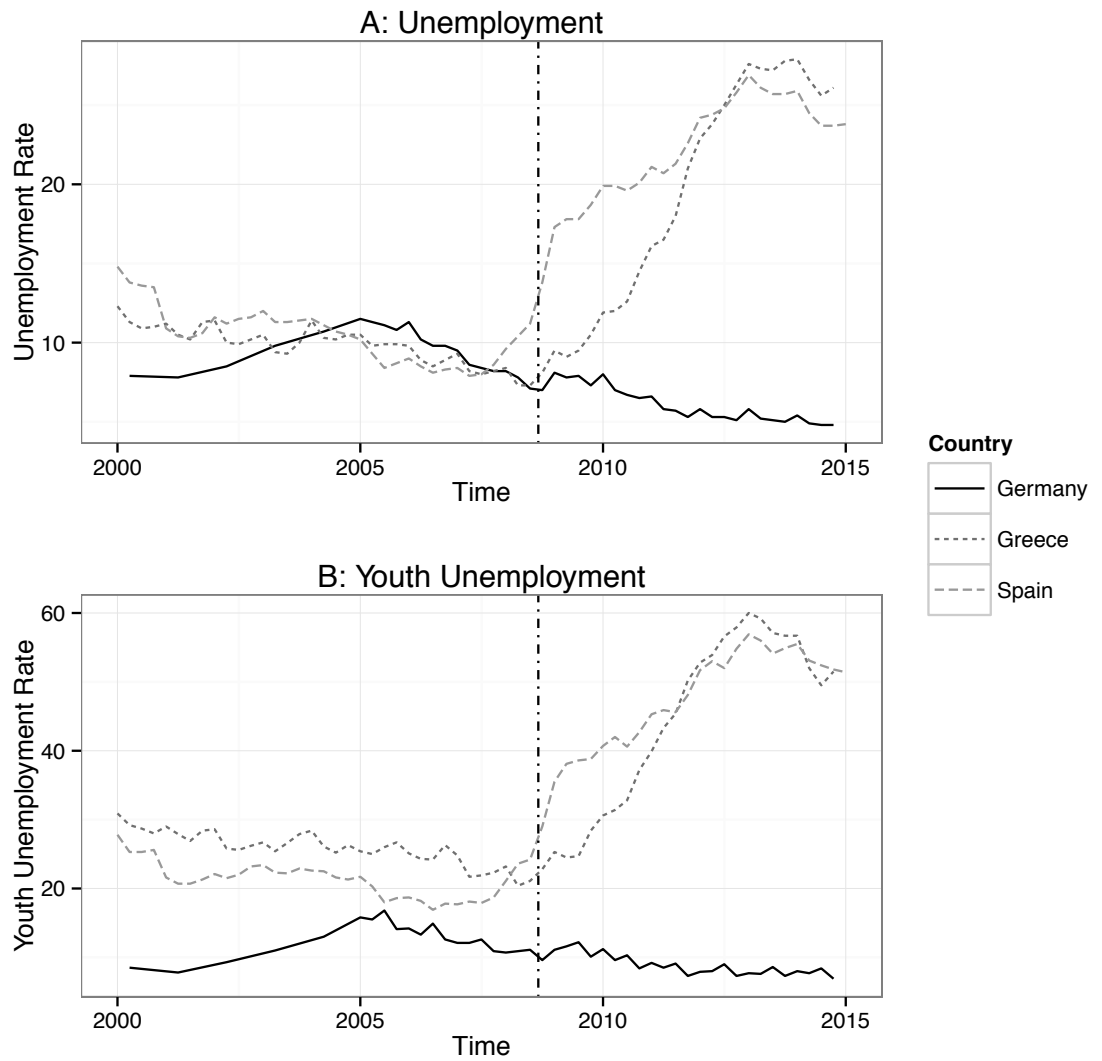
Source: IMF (2015a)

Figure 2: Structural Balance as a Percentage of GDP of Germany, Greece, and Spain, 2000 - 2015



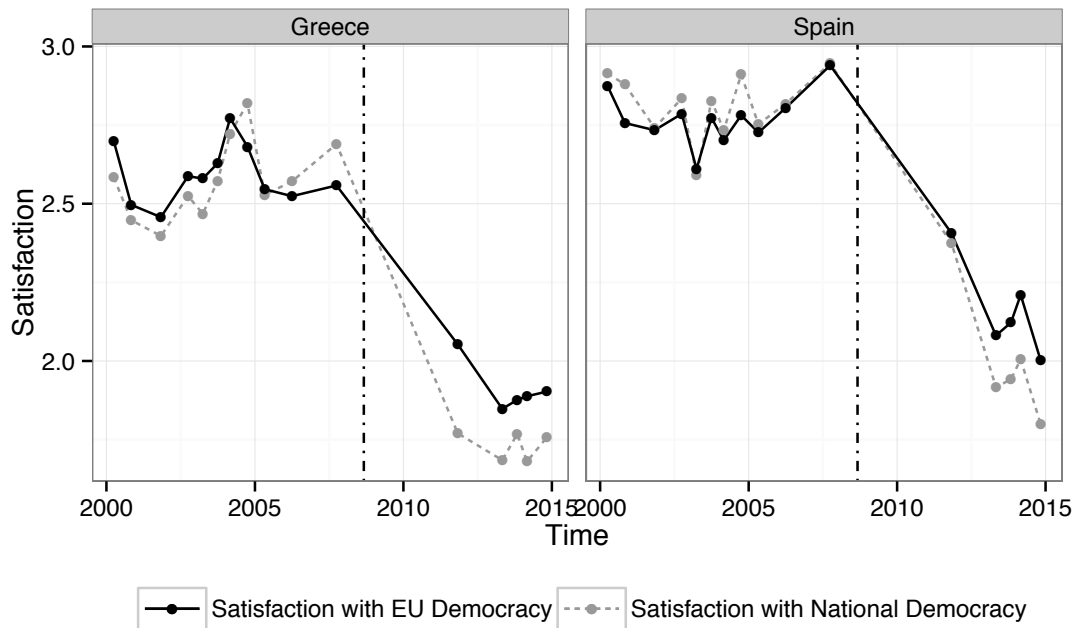
Source: OECD (2015a)

Figure 3: Unemployment Rate in Germany, Greece, and Spain, 2000- 2015



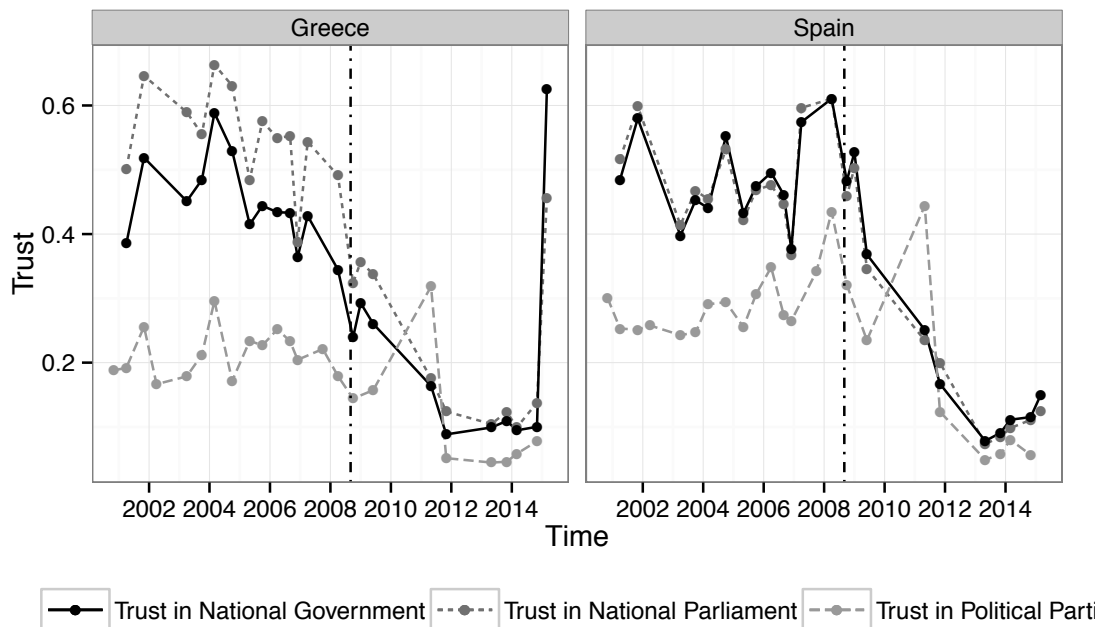
Source: Eurostat 2015

Figure 4: Satisfaction with EU and National Democracy, 2000-2015



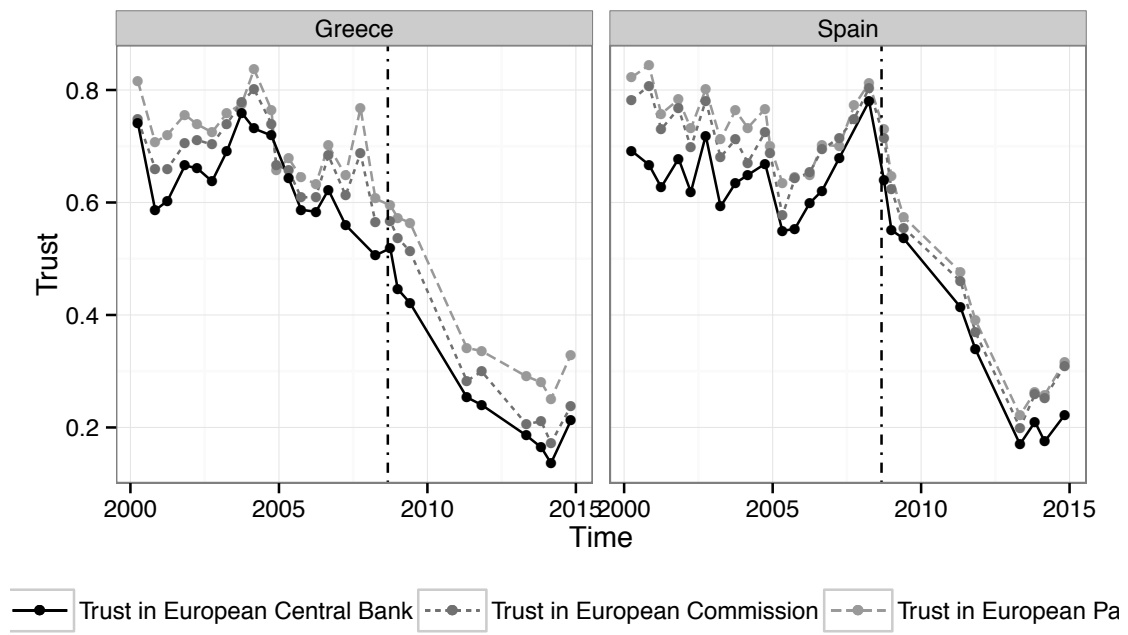
Source: European Commission (2015)

Figure 5: Trust in National Institutions, 2000-2015



Source: European Commission (2015)

Figure 6: Trust in European Institutions, 2000-2015



Source: European Commission (2015)

**Tables**

Table 1: Gini Coefficient in Germany, Greece, and Spain, 2000 – 2014

<i>Year</i>	<b>Germany</b>	<b>Greece</b>	<b>Spain</b>
2005	26.1	33.2	32.2
2006	26.8	34.3	31.9
2007	30.4	34.3	31.9
2008	30.2	33.4	31.9
2009	29.1	33.1	32.9
2010	29.3	32.9	33.5
2011	29.0	33.5	34.0
2012	28.3	34.3	34.2
2013	29.7	34.4	33.7
2014	30.7	34.5	34.7

*Source: Eurostat (2015d)*

Table 2: Spain General elections results 2008-2015

<i>Party</i>	<b>2008</b>	<b>2011</b>	<b>2015</b>
PP	39.9 (154)	44.6 (186)	28.7 (123)
PSOE	43.9 (169)	28.7 (110)	22 (90)
IU	3.8 (2)	6.9 (11)	3.7 (2)
Podemos	-	-	20.7 (69)
Ciudadanos	-	-	13.9 (40)
Turnout (%)	73.4	68.9	69.7

*Note: Number of seats in parenthesis.*

Table 3: Greece General elections results 2009-2015

<i>Party</i>	<b>2009</b>	<b>2012</b>		<b>2015</b>	
		May	June	January	September
ND	33.5 (91)	18.8 (108)	29.6 (129)	27.8 (76)	28.1 (75)
PASOK	43.9 (160)	13.2 (41)	12.3 (33)	4.7 (13)	6.3 (17)
SYRIZA	4.6 (13)	16.8 (52)	26.9 (71)	36.3 (149)	35.5 (145)
KKE	7.5 (21)	8.5 (26)	4.5 (12)	5.5 (15)	5.5 (15)
XA	0.3 (0)	7 (21)	6.9 (18)	6.3 (17)	7 (18)
ANEL	-	10.6 (33)	7.5 (20)	4.7 (13)	3.7 (10)
Turnout (%)	70.9	65.1	62.5	63.6	56.6

*Note: Number of seats in parenthesis.*

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