The New Southern Question: The EU Crisis and the Spectre of Labour Market Reform in Italy and Spain

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FIRST DRAFT: NOT FOR QUOTATION
Just before being condemned to a fascist prison in 1927, Antonio Gramsci penned one of his most famous writings on Italian development, *The Southern Question*, in which he stated: “The South is the ball and chain that prevents more rapid progress..... if the South is underdeveloped it is not the fault of the capitalist system, or any other historical cause, but that nature has made Southerners lazy, incapable, criminal and barbaric” (2004, 20). Gramsci of course, was referring to the racist perspectives of Reformist socialists (and others) in Northern Italy towards their fellow citizens in the South. However, in the contemporary crisis of Southern Europe (Greece, Italy, Spain and Portugal) a similar rhetoric is being used by Northern European media (especially in Germany) and indeed by some policy makers in both Northern and Southern Europe to describe what they view as one of the root causes of the southern European crisis. Thus Italian interior minister Anna Maria Cancellieri resurrected the old concern that Italians are not masculine enough, describing her constituents, including presumably the women, as ‘mummy’s boys’ for ‘expecting’ lifetime employment and being unwilling to move to find work (Caon, 2012). Likewise, in a statement which no doubt surprised Spaniards aware that their nation is in the bottom of European rankings in health, education and welfare expenditures (Banyuls, et al 2009, 3), Spanish cabinet minister Anna Palacio (2012) stated “We Spaniards need to let go of our sense of entitlement to job security and welfare, if we are to succeed in reviving the economy and preserving the essence of our generous welfare system”.

Not to be left behind, New York Times columnist David Brooks (2011) drawing on an American Enterprise Institute report by the Maxwell School’s very own Arthur Brooks, was moved to write about his concern that hardworking, rule abiding Dutch and German’s should now have to bail-out South European’s not sharing such values. His homily concluded: “Money should go to people on the basis of merit and enterprise. Self-control should be rewarded while laziness and self-indulgence should not”. While mainstream media and policy makers often use a more analytic and dispassionate discourse to analyze labour market reform, nonetheless discourses such as ‘stifling’, ‘scloretic’ and ‘rigid’ are often used to describe southern European labour market systems.¹

¹ For example, Alderman’s article in the New York Times, 11th August 2012 leads with “Italy wrestles with rewriting its stifling labor laws”. While long on emotive language and anecdotes of work-shy, if not criminal behavior by employees coddled by employment protections a closer read actually reveals a different story. The interviewed employer (Pallini Liquors) outlines the many challenges the firms confronts—such as the difficulty in raising capital and Italy’s deep recession, such that it is not clear how the de-regulation of hiring and firing would fundamentally change the firm’s fortunes. Similarly *The Economist* (2008) also emphasizes anecdotes of work avoidance and sometimes criminal behavior by Italian public sector
In this paper then I analyze how labour market reform and in particular, flexibility and the de-regulation of Employment Protection Legislation (EPL), such as worker dismissal, has come to play such a promote role in both the discourses and policy recommendations surrounding the current crisis in Spain and Italy. I focus on the latter nations as they are the largest of the southern European economies and have significant similarities in their post-war development. I firstly define labour market flexibility and the different ways it has been adopted by EU nations. I then outline briefly how Spanish and Italian labour markets evolved in the post-war period. With some sectoral and regional exceptions, both nations based development on low paid labour, working long hours characterized by relatively low productivity and innovation. I stress that problems in Italian and Spanish labour markets since 1980 are deeply rooted in their post-war development models. One main response by governments and employers has been to enhance labour market flexibility by creating new tiers of temporary employment characterized by easier dismissal than by permanent and often unionized workers. The result has been to deepen labour market segmentation especially for younger, female and immigrant employees. I then focus on why EPL de-regulation and labour market flexibility has gained such prominence in policy and academic analysis of the current crisis which is largely one of EU and Southern European financial systems. In the current crisis policy makers are attempting to further ease dismissal of those with permanent contracts as way of encouraging hiring and enhanced innovation and productivity. However, I argue that these reforms are likely to further casualize workers and much research indicates that this will actually weaken the likelihood firms will invest in training and increase productivity and innovation. Indeed, I conclude that such restructuring may only deepen the crisis of Spanish and Italian development especially in period of austerity and declining demand.

employees under the title of “Idlers under attack: A reformer takes on Italy’s bloated public sector”. The latter assertion however is not evident in comparative EU data which reveals that Italy’s public sector employment as a share of total population is 2.4 which is below that of hypercompetitive Germany (3.8) and the UK (3.1) (Ministry of the Presidency, 2010).

Finally, Kirkegaard (2011) writing in the Peterson Institute for International Economics concludes regarding Portugal that “it is not an appropriate role for the ECB to provide unconditional financial support to a eurozone government, which is clearly failing to grasp the cause of its current problems”. Without any analysis of other possible factors contributing to Portugal’s and Southern Europe’s crisis, Kirkegaard directly correlates the cause “in one chart” to a low skilled, overprotected labour market.
Labour Market Flexibility in Europe

One of the most significant developments in European labour market policy over the last 30 years has been labour market flexibility (Atkinson, 1984). Labour flexibility is usually viewed as consisting of three facets: (i) numerical flexibility – i.e. largely external adjustments through hiring and firing allowing firms to more closely match supply and demand. (ii) Wage flexibility - the responsiveness of wages to economic changes and shocks. Both (i) and (ii) are often related as they are largely focused on reducing or minimizing labour costs (Lucidi and Kleinknecht, 2010, 529). (iii) Functional flexibility which are largely internal adjustments in which firms multiskill workers, deploy new forms group work and is often accompanied by investments in training and skills. This strategy is more consistent with improving productivity and innovation in particular by promoting firm learning (Arundel et al, 2007). There is often considered to be a trade-off between (i) and (ii) and functional flexibility. Thus workers with greater functional flexibility can often be less prone to lay-off and indeed firms may be very reluctant to lose accumulated human capital and knowledge. In contrast, a more numerically flexible workforce may have little formal training and thus the firm may not have significant incentives to keep or enhance this segment’s skills when confronted with a decline in demand.

Post-1975 declines in employment growth and increasingly unemployment led many policy makers to argue that Europe suffered from over-regulated and inflexible labour markets. Only by embracing more freemarket policies could Europe hope to regain its post-war growth path. Thus the UK under Thatcher (1979-1990) attacked trade unions and EPL and wage setting institutions in order to free up employers to more flexibly match supply with demand in part by developing the non-standard and casual workforce. It was much less focused upon enhancing functional flexibility.

Although influential, the more extreme neo-liberal labour market Thatcherite experiment was never adopted by most continental European EU nations. Nonetheless, by 2000 these nations had adopted a number of measures to increase labour market flexibility. Continental EU nations can be divided into two main types of labour market policy. The first are nations such as Denmark and The Netherlands which have adopted a ‘flexicurity’ system based on moderately loose regulation of permanent employment with generous but rigidly enforced unemployment benefits and second is that found more in Southern Europe where permanent employment is characterized by relatively ‘rigid’ EPL with newer temporary contracts have significantly less job protections (Nunziata, 2008, 21). While I will return to discuss the relevancy of the northern European flexicurity model I firstly want to turn attention to the development and impacts of the latter system in Spain and Italy.
Spain and Italy’s Post-War Development Models and Labour Market Reform

Both Spain and Italy developed along similar paths in the post-1945 period. Spain of course entered the post-war period under the Franco dictatorship (1939-1975) and while initially adopting autarkic development policies began to open up its economy to inward investment by the late 1950s. Under Franco, Spain had an authoritarian corporatist employment system in which trade unions were banned, but in which there were extensive employment protections for especially permanent workers (largely males) while females were largely confined to the domestic sphere and some service jobs (Rodriguez and Lucio, 2012). Not surprisingly, labour relations were based on low trust between employees and employers (Banyuls et al, 2009). As Spain entered the post-Franco period it had a very skewed economy with a handful of very large firms (both state, private and often foreign-owned), alongside a large number of small enterprises which were largely geared to domestic consumption. A continuing problem is the traditional model of competitiveness many firms adopt which relies on low labour costs with a low priority given to productivity and innovation (Banyuls, et al 2009, 5). In terms of industrial relations the Monclao Pact (1977) featured the legalization of unions who became significant political actors. However, while unions were strong in larger enterprises they remained weak in smaller ones. The Pact also led to the enlargement of the welfare state and the continuation of some Franco EPLs which were viewed as critical to sustain worker support in the transition to democracy. Thus dismissal from permanent jobs was regulated via seniority, reason for dismissal, appeal to labour courts and in some cases advance notice requirements (Bentolila et al, 2008).

Italy entered the post-war period with a legacy of fascism and war. Moreover, like Spain it developed a very sectorally and regionally uneven economy (Simonazzi et al, 2008). Thus, while large industrial concerns such as Fiat dominated the North, the South remained very underdeveloped with low rates of labour market participation in the formal economy. In the post-war period the South suffered a high level of out-migration to the North. Especially after 1970 a vibrant economy of small-medium sized firms developed in the so-called Terzo Italia or Third Italy in regions such as the Emilia-Romagna and Tuscany. However like Spain, most Italian firms made low investments in formal R+D and relied on incremental innovation, low labour costs and long working hours to compete (Simonazzi et al, 2008). While Italian unions entered the post-war period stronger than Spanish ones they also inherited some labour statutes from the fascist period (Caruso, 2004). Moreover union impacts on Italian EPL were largely a response to a wave of worker strikes and plant occupations in the late 1960s. The Workers Charter of 1970 (Clause 18 of the Italian Penal Code) was based on standard or permanent employee and was designed to protect workers and union activists from unfair dismissal in firms with more than 15 employees (Simonazzi, 2008, 3). Italian labour law was also based on the principle of interrogability which prevented two parties from negotiating a relationship
worse than those laid down in collective contracts (Caruso, 2004, 9). Like Spain the social protection system was expanded but was not universal. Indeed combined with the gradations of the EPL by firm size it reinforced the dualistic nature of the Italian economy. Furthermore, similar to Spain the underdeveloped nature of social welfare relied upon the household and especially unpaid female labour to ensure social reproduction. While both nations have subsequently expanded their welfare state systems they are less developed than in Northern Europe.

As the post-war boom ended in the late 1970s, both Spanish and Italian unemployment increased significantly. In response employers and the state began to advocate for reforms to the labour market and in particular the liberalizing of EPLs. By the 1980s-1990s both nations had loosened regulations on temporary employees and other employment standards while also introducing private employment agencies. In Spain, one the main thrusts of such reforms was the lowering of dismissal costs for temporary employees compared to permanent ones. This was furthered in 1997 by the creation of a new middle strata of permanent employees who also have dismissal costs lower than those on older permanent contracts (Bentolila, et al, 2008, p. 51). These efforts to enhance employment flexibility coincided with efforts to decentralize industrial relations.

By the eve of the current economic crisis in 2008 the cumulative effects of reforms to EPL had had a significant impact on both the Spanish and Italian labour markets. By 2009 the share of employees on temporary contracts in both nations had more than doubled since the 1980s with over a third of the Spanish workforce being employed on temporary contracts (the highest share in the EU) while the Italian rate was just under 15 percent (OECD, 2011). In Italy, the relative strength of unions, meant that EPL reforms had to be negotiated, which mitigated the neoliberal inflection of such policies, but also meant that the impacts very uneven. Thus temporary employment growth and declining dismissal protections have impacted women, younger workers and immigrants much more than older males.

_A Crisis is a Terrible Thing to Waste: Labour Market Reform and the Current EU Crisis_

Italy and Spain have thus enhanced labour market flexibility over the last thirty years. Nonetheless, the current crisis has if anything, witnessed increasing calls from policy makers and politicians within Spain, Italy and the EU to further reduce the barriers to and costs of employee dismissal. Certainly the depth of this crisis is not in doubt. Not only has economic output especially in Spain declined significantly, but since 2009 unemployment has reached record levels—over 25 per cent of the total workforce (see Table One). The crisis in Spain is more severe than that in Italy since most of the former’s post 2000 growth was based on relatively short-run speculative expansion of construction, tourism and internal consumption heavily financed by private debt (Banyuls, 2009, 3). Nonetheless, Italy has also entered the
crisis with unemployment now 10.7% while that for those aged 15-34 is 35%. Increasing unemployment, plant closures and cuts to public spending have especially in Spain significantly weakened union and left of centre opposition to labour market changes and have emboldened employer associations and neo-liberal policy makers to deepen attacks on EPL which often includes an uncritical embrace of the US labour market and management model (Rodríguez and Lucio, 2012).

To this end the current Spanish and Italian governments have introduced further changes to EPL –especially for the dismissal of permanent employees. In Spain firms can now dismiss employees with a redundancy payment of 33 days per annum worked, rather than the previous 45 days and those firms in financial difficulties can lay-off workers with 20 days’ pay per year employed. The Spanish state is also making it easier for firms to dismiss ‘unproductive employees’ and providing incentives for firms to hire younger workers through reducing firm social security payments. Measures have also introduced to simplify regulations on collective dismissal and shifts in employee working time. In Italy the principal focus has been on reform to Article 18 of the Penal Code which is viewed as protecting older, permanent workers at the expense of younger, temporary employees. However, thus far the continued relative strength of the Italian left and unions has meant that reforms to Clause 18 have been modified and will allow employee reinstatement if a labour court finds that there are insufficient reasons for dismissal (Donadio, 2012).

The case that is made for such reforms by international policy bodies such as the IMF (Schindler, 2009; Jaumotte, 2011; IMF 2012) is that while the de jure labour market regulations of nations such as Italy and Spain are not notably inflexible, their labour market outcomes are amongst the worst in the EU. This is attributed to an overly centralized system of collective bargaining, an uneven unemployment benefit system and remaining significant barriers to employment flexibility amongst full-time and permanent workers (Schindler, 2009, 7-8; Jaumotte, 2011, 3-4). For example, when comparing EPL across the EU and other OECD nations, Italy and especially Spain, have stricter legislation, although Italy’s is below that of Germany, Norway and France (OECD, 2009, 8). (see Figure One). Thus Spain is viewed as especially dysfunctional in this regard. Not only are severance payments for permanent employees above the EU average, but the intermediate nature of wage bargaining by which unions can extend wage agreements to a high share of non-unionized workers is viewed as exacerbating insider-outsider divisions (Jaumotte, 2011).

There are indeed many elements of disfunctionality in Spanish and Italian labour markets. These include seemingly arcane and overly bureaucratic professional and occupational

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2 Overall EPL is defined by the OECD (2011) as including regulation of regular and temporary contracts and regulation of collective dismissals.
regulations. There is relatively little support in labour market policy for developing human
capital (for example, much of Spain’s labour market expenditures go towards wage subsidies)
or as importantly to promote better work-life balance and to give better support for working
women with domestic responsibilities. Spanish and Italian labour market reform over the last
30 years has also deepened labour market segmentation between permanent and temporary
employees with overall employment rates for younger workers and women remaining
consistently below EU averages (see Table One). Furthermore, there remain in both nations
very deep regional inequalities, such as in Italy where Mezzogiorno unemployment rates are
between 2.5-3.0 times those of the centre-north, with the former having long suffered from an
outflow of qualified skilled workers further depressing its economic performance.

Certainly, the IMF, OECD and other policy makers also advocate for reforms to product
market regulation and welfare state provision and other changes, but enhancing Spanish and
Italian labour market flexibility via deregulating industrial relations and dismissal are given a
very high priority. Thus the IMF (2012, 2) concludes that in the Italian case higher employment
in Italy can be achieved by “allowing companies to lay-off workers for economic reasons and
reducing the cost of dismissal”. Combined with de--regulating product markets the IMF
estimates this would also attract more foreign investment and “increase the level of the
[Italian] GDP by about 6 per cent over the medium term”.

However, privileging reductions in EPL as key to reviving the Spanish and Italian
economies is open to critique. First, the evidence that making labour markets more flexible
leads to job gains is mixed and is impacted by other factors including overall macro-economic
conditions (Bentolila et al, 2008). It is even less clear that loosening EPL actually enhances
overall economic development or leads to sustained growth (see Bosch et al, 2007; Jaumotte,
2011; Lucidi and Kleinknecht, 2010). Secondly, de jure indicators do not reveal whether EPL is
actually enforced. Thus Mexico and Turkey all have significantly higher EPL than Spain or Italy
but it well known that especially in the case of the former these are rarely enforced (Juamotte,
2011). Thus ‘reading off’ from macro-indicators can be misleading regarding actual EPL
practices. For example, there is already considerable flexibility and decentralization in Italian
industrial relations. Italy has two systems with one based on industry-wide agreements and the
other which has become more prominent which is a second-level, decentralized system. Second
bargaining level, generally within companies, helps to accommodate the differences between
large and small enterprises, as well as between the north and south of the country and can also
include more regional or local ‘territorial pacts’ (EIRO, 2010; Caruso, 2004). Indeed, especially
since the ending of wage indexing (scala mobile) in the 1990s, Italian real wage ga
rains have been
well below productivity increases (Lucidi and Kleinknecht, 2010). Moreover, despite some
claims to the contrary (Jaumotte, 2011), Spanish unions and collective agreements have a
nominal impact at the enterprise scale (Rodriguez and Lucio, 2012, 6). Unions have a weak presence in small and medium sized firms and like Italian unions, Spanish ones have struggled to organize the increasing share of workers in non-standard employment (Banyuls et al, 2008).

Furthermore, by some measures Italy and Spain are relatively flexible labour markets compared to other EU nations. Thus Italians and Spanish work longer hours than German and Dutch employees and the flexibility of Italian working hours is comparable to the ‘hyper-flexible’ UK and greater than that found in Germany and Holland (Caruso, 2004, 29). Similarly, the 2009 “Difficulty in Firing” index in the Doing Business report by the World Bank rated Spain one of the least difficult of the EU-15 with Ireland, Denmark, the UK, and Belgium being rated as more difficult and Germany and Portugal offering more weeks of salary as dismissal costs (cited in Rodriguez and Lucio, 2012, 19). Finally, as Rodriguez and Lucio (2012,6) argue in the case of Spain, any labour market which in 2009 was able to shed more than a million jobs including 400,000 which were collective dismissals requiring government approval, is not suggestive of one where firing workers is a significant problem.

Certainly not all policy makers focus solely on easing employee dismissal as the way to reinvigorate the Italian and Spanish economies and also advocate for increased human capital investment and a wider welfare state and unemployment benefit system (see, Scuilli, 2006; Nunziata, 2008). Indeed across all advanced economies, employment systems and some worker preferences have shifted from the post-war, full-time standard employment model. Nonetheless, there are clear choices regarding whether policies work to balance the interests of employers and employees. Thus those advocating a more a Northern European flexicurity model based not only upon easier dismissal but also on a more universal and regulated social welfare system and active labour market policies, argue these offer a better balancing of interests. Yet while the Netherlands and Danish flexicurity systems are often held out as ‘success stories’ not only has their employment performances since the early 1990s depended on overall macro-economic conditions, a specific sectoral mix and other variables, but their actual employment performance is less impressive once their often ‘hidden’ trade-offs (such as high taxes) are accounted for (Auer and Gazier, 2008). Moreover, even if the Northern European flexicurity systems were unambiguously successful and similar macro-economic conditions prevailed, some economists (see Nunziata, 2008) warn that Spain and Italy lack conditions such as the high levels of social trust prevailing in nations such as Denmark. Moreover, thus far proposals in Italy and Spain to adopt more flexible hours prioritize firm over individual and family needs to much greater degree than similar arrangements in the Netherlands (Caruso, 2004, 20; Banyuls, et al 2009).

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3 In 2008 Italian unions represented over 35% of all employees and collective bargaining coverage was extended to 80% of the workforce. In contrast only 17% on the Spanish workforce is unionized with collective agreements covering some 60% of the workforce.
It is also important to emphasize the current focus in Italy and Spain on EPL and dismissal deregulation is often based on a very narrow set of neo-classical economic assumptions (Lucidi and Kleinknecht, 2010). These assume that EPL is inevitably associated with increasing costs to firms and ultimately lower employment and productivity. Alternative Schumpeterian perspectives stress that firms can adjust in very positive ways to EPL by investing more in employee training, and by raising productivity, innovation and employment. Thus relaxing employment security can reduce the likelihood of employer investment in training and the willingness of employees to participate in innovation. Indeed, this latter view is borne out by studies of the actual impact of existing flexibility reforms in Spain and Italy, which while they have led to job gains, have also been associated with lower productivity and innovation, little upward movement from temporary to permanent employment and reduced geographic mobility by the unemployed (see Scuilli, 2006; Benotlila et al, 2008; Nunziata, 2008; Lucindi and Kleinknecht, 2009; Lasinino and Valenti, 2012). For example, Lucidi and Kleinknecht (2010, 540) analysis of data from 3000 firms Italian manufacturing firms between 2001-03, found that while introducing flexible labour reforms lead to some employment creation, this was accompanied by lower productivity not only by newly hired workers but also by existing employees (see also Lasinino and Valenti, 2012). Greater external flexibility and employment insecurity then may actually negatively impact the competitiveness of Spanish and especially Italian manufacturing firms, who given their relatively low rates levels of R+D investment rely heavily on incremental innovation based on workforce knowledge.

Thus it is very questionable whether Spanish and Italian labour market dysfunctionality if not their overall economic problems, can be reversed if only workers in more permanent employment strata are equally exposed to the easier dismissal of workers in temporary employment (Schindler, 2009; Jaumotte, 2011). Even if the contemporary macro-economic conditions facing Italy and Spain were more positive, this mainstream assumption would seem to be flawed in part because it focuses so narrowly on the supply-side conditions of the labour market. Indeed as (Banyuls, 2009, 10) emphasize in Spain:

A common point of labour policies in Spain has been the aim to encourage business competitiveness by means of the reduction of labour costs, rather than promoting productivity increasing cooperation between employers and employees, [and] training

Thus Rodriguez and Lucio (2012) argue that this single minded focus means that:

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4 At 1.39% and 1.26% in respectively Spanish and Italian investment in R+D as a share gross domestic expenditure in 2011 were well below the EU average of 2.0%. (EUROSTAT, 2011)
In Spain the image of workers being virtually impossible to dismiss has taken on such importance that the quality of employment, the nature of work and the reality of flexibility on contractual terms are pushed into the background.

Supply-side biases also exist amongst many policy-makers in Italy. Thus the relative short supply of educated people in Italy has been viewed as drag on the innovative capacities of Italian firms, but in fact declining returns to higher education investment since the 1990s suggests that the problem is more reflective of the low demand by employers whose existing production specialization actually requires less high skilled labour (Simonnazzi, 2008, 11). Moreover, when organizations like the IMF examine the demand side, their recommendations for product market de-regulation and privatization inevitably assume that these will generate positive impacts (see Schindler, 2009; IMF, 2012). However, as Simonnazzi et all (2008, 8) argue, in the Italian case privatization has mostly favoured the rent seeking activities of large Italian firms and by shifting the latter’s resources away from their core activities has actually reduced their international competitiveness. Indeed, similar doubts by been expressed by some IMF analysts concerning the purported positive impacts of Spanish product market de-regulation (see Jaumotte, 2011).

Conclusions

The argument for easing of Spanish and Italian EPL and especially dismissal laws would seem to rest on some questionable theoretical and empirical grounds. The current crisis is both a longer term one which has been exacerbated by EU expansion to the Central and Eastern European nations and globalization which means that Spain and Italy can no longer compete on relatively low wages, productivity and innovation, and in the shorter term is a financial one that was in part induced by US banks such as Goldman Sachs whose former employees (Monti and Draghi) now preside over the Italian government and the ECB respectively. Nonetheless, with collapsing economies and weakened labour opposition, labour market reforms have been seized upon opportunistically. Disturbingly, in Italy and especially Spain debate about labour market reform has been accompanied by a growing discourse on the part of some policy makers and the media which fall back on old national, if not racist, stereotypes. Spanish and Italian workers are thus viewed as ‘deviant, corrupt and untrustworthy’ (Rodriguez and Lucio, 2012, 14) and where once they required the discipline of an authoritarian state they now need that of the market. Thus the discourse of Gramsci’s Southern Question in the 1920s has been reinvented and has now been extended from southern Italy to encompass all of Southern Europe. But rather than drawing attention to a lack of a true EU development policy to address the problems of deep uneven development between the Northern and the Southern Europe, and the inability of the EU to develop any coherent alternative to its current austerity policies, more attention has been paid to LMP
regulation and the purported behavioral characteristics of Italian and Spanish workers. Instead of alleviating this crisis, current labour market reforms promise to only deepen employment problems in the short run and in the long run offer no positive, sustainable development path.

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