

So Greece Has Cleared Some Obstacles, But Will Spain Overcome Its Hurdles?

- By IRWIN STELZER



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Reuters

People in Madrid pass a Web-site ad that reads, 'We can only fix this together.'

Before waxing ecstatic over Greece's ability to flog some bonds, remember this: Greece is a sideshow. Spain is the main event.

Its economy, the euro zone's fourth largest, is five times the size of Greece's, and almost twice the size of those of other financially struggling countries — Greece, Ireland and Portugal — combined.

So it matters that Spain's socialist prime minister, José Luis Rodríguez Zapatero, seems to be an admirer of Charles Dickens's Mr. Micawber. Ask him what he plans to do about his country's 11.4% fiscal deficit, and he first promises to extend his country's retirement age, and then says he won't. He promises a public-sector wage freeze, but his Finance Minister, Elena Salgado, says he really doesn't mean it. But somehow he will cut the deficit to 3% by 2013. "We have a plan," says Spain's deputy prime minister, Maria Teresa Fernandez de la Vega. To most observers, that plan seems to be Mr. Micawber's: "something will turn up."

Or two somethings. The first is a return to economic growth that will increase tax revenues. Never mind that after sixteen years of growth the economy plunged into recession last year (GDP: -3.7%), and according to the International Monetary Fund is likely to shrink further this year; or that the unemployment rate is crowding 20% (double the euro-zone average) and is headed towards 22% according to some forecasters: or, most important, that after a decade in which labor costs increased at an annual rate of about 4%, Spanish goods are uncompetitive in major export markets.

Continued economic and political problems in Greece mean that Sarkozy's reassurance of euro-zone support won't last; Portugal and Spain also pose risks. As euro-zone growth slows, the ECB will delay rate hikes.

The second "something" is an EU bailout: call it "support." If the rating agencies get stroppy, and the markets turn on Spanish bonds, even Germany won't be able to allow the euro zone's fourth-largest economy to default on its bonds. Or so Mr. Zapatero might hope.

Mr. Zapatero is also relying on two facts. First, Spain is not nearly as indebted as is Greece. Or Italy, or Portugal, or France, or even Germany. Its debt-to-GDP ratio is comfortably below those of other countries, a result of the prudent fiscal policies of predecessor governments. Second, Spain has never over-cooked its books in the manner of Greece. So it enters negotiations with the rating agencies and the bond market with credibility that Greece's serial book-cookers cannot muster, and expectations that it won't have to pay over 3

percentage points more than Germany, as Greece did last week, to tap bond markets.

But Spain's advantages pale into insignificance in comparison with the disadvantages of a huge budget deficit, the absence of a credible plan to reduce it, a continued if moderating declines in economic activity, and the structural defects in its economy. These will count for a lot in the overloaded debt market of the next year or so.

The country's apparent prosperity was based on cheap credit that fueled a construction boom. No one anticipates that the construction industry will recover very soon, not with all those unsold houses on the market. Nor is there much hope for another tourism boom: fun in the sun is a low priority for strapped consumers, and the overbuilt Spanish resort areas are less appealing than they once were, at least to tourists able to spend freely. Finally, the government has little money available to provide seed capital for 21st century industries.

Which will put the burden of long-term recovery on the private sector. Not a bad place. Spain's entrepreneurs have proven that they can do business on a global basis, witness the fact that Spain is Latin America's largest foreign investor. Indeed, a few slip ups aside, Spanish companies have been so successful that there are mutterings of a second generation of Conquistadores descending on South America.

Another plus is that the Spanish banking system "has been relatively insulated from the global financial crisis," according to the C.I.A. rundown on the Spanish economy. The key word is "relatively". The nation's smaller, regional banks, the cajas de ahorros that account for about half of all lending in Spain, are overcommitted to the property market, but are resisting calls from Miguel Angel Fernandez Ordonez, governor of the Bank of Spain, to merge with larger, better capitalized institutions. Still, the banking system is indeed relatively strong. Think Santander.

Against those longer-run strengths must be weighed two important negatives. The government has resisted reforming a rigid labor market in which most workers have contracts that prevent their employers from adjusting their work forces, combined with a benefits

system that seriously reduces incentives to move off the couch and into work.

Second, the rating agencies don't believe the government's growth forecasts, and the markets want firmer and more specific promises of frugality, especially since some 75% of all expenditures are controlled by autonomous regional governments and the social security system. But something might turn up.

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