

Spain Struggles to Agree on a Path to Recovery



Andrea Comas/Reuters

In Madrid, government workers recently protested planned pay cuts. A strike over the proposal is planned for next week.

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MADRID — Caught between a populace resistant to more austerity measures and investors demanding budget cuts and more flexible labor markets, the Spanish government is finding it increasingly difficult to keep a grip on power.

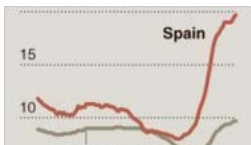
Last week, the government of [José Luis Rodríguez Zapatero](#) narrowly won approval for an extra 15 billion euros, or \$18.4 billion, in spending cuts — in an effort to bring the budget deficit down to 6 percent of the national economic output by 2011, from 11 percent last year. With labor unions and business leaders at loggerheads, Mr. Zapatero is also expected to present a plan for loosening labor rules this week.

Three months ago, a package that reduced the pay of civil servants and made it easier to hire and fire workers would have been hailed as transformative, especially in an economy stuck in a recession for two years and nearing 20 percent unemployment.

Instead, the proposals are being seen as a desperate bid by an unpopular government to remain in office.

On Friday, Spain suffered another

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Manu Fernandez/Associated Press

In Barcelona, public workers on Tuesday protested the government's economic measures.

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J.L. Pino/EFE, via European Pressphoto Agency

Prime Minister José Luis Rodríguez Zapatero's spending cuts passed in Parliament by one vote.

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downgrade of its debt even as calls were increasing for early elections after the close budget vote. Together, the two events suggest to political leaders throughout Europe that voters and investors are fed up with the lack of resolve and leadership in dealing with the economic situation.

“The government made a real mistake in being late in recognizing this crisis and continues to make a mistake in the ‘drip by drip’ measures to solve it,” said Jordi Sevilla, one of Mr. Zapatero’s former ministers. “You can only get credibility by presenting one strong and coherent package.”

Coming up with something strong and coherent that would satisfy all the various constituencies is no easy task. And Mr. Zapatero is under pressure from all sides.

In light of the international rescue package for Greece, investors want Spain to demonstrate that it can cut its bloated deficit fast enough to avoid emergency aid. Given the size of the Spanish economy, a rescue would be much more costly than the Greek bailout. Yet a debt default or severe restructuring would be even worse, crippling foreign banks whose lending underpinned Spain’s debt splurge.

In domestic politics, meanwhile, the center-right Popular Party opposition is smelling blood. The parliamentary review last week of the spending cuts, which Mr. Zapatero won by a single vote, suggests that an even bigger struggle looms in budgetary talks later this year, perhaps even requiring him to call early elections.

In fact, most Spaniards now say they would like to cast their vote again, according to an opinion poll conducted by Sigma Dos and published Sunday by the newspaper El Mundo.

Mr. Zapatero, whose term in office is due to end in 2012, requires support from smaller parties to pass legislation because his Socialist party does not command a majority in Parliament.

Adding to the government’s woes, labor unions, a mainstay of the Socialists, have started to rally against Mr. Zapatero’s plans for change.

Civil servants are expected to strike next week over a 5 percent cut in their wages. Unions also warned last week that a general strike would be their response to any “hurtful” labor market changes.

Even though early elections are rare in Spain, they are now “absolutely” needed, said [José María Aznar](#), the center-right former prime minister who led Spain into [the euro](#).

“The problem is not if we have a government of the right or the left,” Mr. Aznar said. “It’s a question of competence, and at the moment we just don’t have a competent government. Living six more months with this government is taking an enormous risk for this country.”

The [19.7 percent](#) jobless rate in Spain is almost twice the euro zone average of 10.1 percent — even as Spanish companies face some of Europe’s highest costs for dismissing workers with open-ended contracts, according to the [World Bank](#).

Trying to avoid rigid labor rules, employers have shifted a quarter of the country’s work force to temporary contracts, helping explain the sharp swing in Spain’s employment level. The result has been to pass the pain mostly on to younger workers because older employees are generally well protected.

“For 10 years, we were the machine for creating employment in

Europe, and now we have turned into the machine for destroying employment," said Ángel Torres Torres, secretary general for economic policy and international affairs in the Spanish Economics Ministry.

Mr. Zapatero has pledged to cut the budget deficit to 3 percent of gross domestic product by 2013 — the limit under euro rules — from 11.2 percent in 2009. Spain's central bank said on Monday the latest austerity measures "strengthened substantially" the likelihood of reaching that goal.

But the government also lowered its 2011 growth forecast on Friday to 1.3 percent from 1.8 percent. Moreover, many private economists are skeptical of those projections, which suggest that Spain could fall far short of its deficit-cutting goals. Mr. Zapatero recently warned the rich to expect higher taxes, an indication that his austerity package was not yet complete.

In the government's defense, José Manuel Campa, the deputy finance minister, argued that officials were not dithering, but could only introduce changes as fast as Spain's divisive political context allowed.

"We're a government that does not have a parliamentary majority, so we need to think about the right timing for every measure," he said.

In neighboring Portugal, the main rival parties recently agreed on an austerity package, but in Spain the Popular Party voted against spending cuts last week, without convincing most analysts that it had anything better to offer.

With 25 billion euros in refinancing coming due in July and with Spain's cost for issuing new debt now elevated by more than a full percentage point, Mr. Campa acknowledged that even the government's best efforts may not appease impatient investors.

"We have to get ahead of the curve for the markets," he conceded.

Part of what worries investors is the tremendous overhang of souring real estate loans — the residue of Spain's collapsed property boom — that languish on the balance sheets of the country's banks.

José García Montalvo, an economist in Barcelona, estimates that of the 450 billion euros in loans to the property sector, 165 billion euros are problematic and this number is bound to rise if real estate prices keep falling.

Mr. Campa cited an [International Monetary Fund](#) stress test that concluded Spanish banks would need to raise no more than 25 billion euros against bad loans.

Spaniards once thought their country was largely insulated from the debt crises in Ireland and Greece. Their mood has changed from giddy, when their homes tripled in value and they were protected by an elaborate safety net of public aid and family support, to grim.

Always a country of savers — in contrast to Portugal and Greece — Spaniards have begun to sock away even more. Household savings have almost doubled in two years to 19 percent, according to data from Spain's central bank.

Now, as they make their own sacrifices, some wonder whether Mr. Zapatero, who has been broadly criticized for not owning up to the seriousness of the crisis, can bring himself and other officials, particularly those in the regional governments, to do the same.


“He spends money on everything, from cars for his ministers to recreation facilities for the trade unions,” said Adriano Molina, a retired lawyer in Madrid. “But we can no longer afford all that.”

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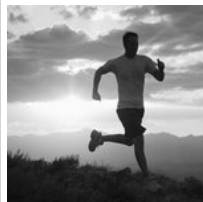
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