Why Spain Won't Reform

Catalans know first-hand that in Spain, all roads—and high-speed rail—run through Madrid.

By RAYMOND ZHONG

Barcelona

Is Spain next to go on the Brussels dole? Not if the assurances coming out of Spanish officials lately are to be believed.

Prime Minister Mariano Rajoy, addressing reporters in Poland this month: “Spain will not be rescued. The alarm is unjustified. . . . It’s not possible to rescue Spain. There’s no intention of it, and we don’t need it.”

Mr. Rajoy, at a conference of his People’s Party in Madrid: “[Investors] lend to you if they are confident you will pay it back. . . . There are countries near to us that couldn’t, and they are in the situation everyone knows about. This is not the case for Spain.”

Economy Minister Luis de Guindos, on the possibility of a Spanish bank rescue: “The government won’t create anything, neither a good bank nor a bad bank, and there won’t even be the smallest bit of public money available.”

The good news is that markets don’t seem to be buying Madrid’s sanguinity. That’s also, of course, the bad news.

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Spain’s crisis isn’t of a piece with Greece’s or Portugal’s, and it won’t be resolved in the same way. The Spanish economy is much larger, but its ailments are not principally fiscal. Public debt was 65.8% of GDP at the end of last year. Indebtedness actually fell between 1996 and 2007 before climbing again during the financial crisis.

Rather than fixating on deficit targets, official Europe should be watching the danger lurking in Spanish banks. Like the Irish, Spaniards overinvested in property during the easy-money days, and banks’ losses on residential mortgage-backed securities will probably trigger some form of public support as the housing bubble deflates further. Irish property values halved between peak and trough, whereas Spanish real-estate prices have so far only fallen about a quarter from their 2007 highs.

Still, the billion-euro issues are growth and structural reform. On these, too, Mr. Rajoy has assured and reassured markets and policy makers of his resolve. But here in Catalonia, the autonomous region of Spain whose capital is Barcelona, few are counting on Madrid to do the right thing.

For now, the evidence is on the doubters’ side. In February, the prime minister passed a major law that addressed, among the Spanish labor market’s many malignancies, Spain’s menu of around 40 types of employment contracts. As Mr. de Guindos wrote in a Journal op-ed in January, Madrid’s goal is a system with two contracts: one for full-time workers and another for temporary labor.

Yet February’s reform did not reduce the number of contracts. Instead, it created a new one, for firms with fewer than 50 employees.
Catalans have additional reasons to question the Spanish government’s capacity for change. Of late, Mr. Rajoy has been blaming Spain’s regional governments for the country’s deficit overruns, saying that wayward local spending had jeopardized the entire nation’s creditworthiness. Madrid has threatened to intervene in the regional governments’ budgets if they don’t tidy their books on their own.

But according to Andreu Mas-Colell, Catalonia’s economy minister, the real story is a little different. He explains that with the exception of the Basque Country, Spain’s 17 regions enjoy spending autonomy but almost no revenue autonomy. It’s up to the central government to decide how nationwide revenue gets distributed between regions, and there’s no guarantee that what a region’s citizens pay to Madrid is returned euro-for-euro in funding to that region.

That means the central government can make its own budget shortfalls look smaller—and the regional governments’ look bigger—simply by keeping more of the revenue pot to itself.

The result? Catalonia is the seat of Spanish industry and one of the most important industrial districts in Europe, lagging only the likes of Italy’s Lombardy and the German Ruhr in productivity. Yet each year since 1986, an average of 9% of Catalonia’s GDP in net terms has left the region to be redistributed or spent by Madrid. In Spain, only the Balearic Islands surrender a larger share of their annual output. Nowhere else in Europe or North America do intra-national transfers of such size occur as a matter of course.

“In discretionary expenses we feel we have been historically shortchanged,” Mr. Mas-Colell says. “We represent 15% of the population, and we represent close to 18% in terms of GNP... In this year’s budget, the investment in Catalonia is 11% of public investment in Spain.”

“There are inefficiencies in the autonomous communities for sure,” he adds. “But not to a larger extent than the inefficiencies in the central administration. ... Spain in all its components has to gain on efficiency, on liberalization, on flexibility.”

Seen this way, Madrid’s threats to recentralize fiscal policy look like a political play that distracts from reforms that could actually help the regional governments close their budget gaps. Mr. Mas-Colell says that it’s up to Madrid, for instance, to make regulatory changes that would enable hospitals to charge for prescriptions, meals and overnight stays, as his government is trying to do.

He also notes that Barcelona has cut government employees’ wages. Madrid hasn’t.

It’s a little bewildering that Madrid would choose to inflame separatist feeling in Catalonia at a time of national crisis. More than 40% of Catalans now say they’d support seceding from Spain. But Madrid’s centuries-long jiu-jitsu with the regions suggests something about the national character, according to Germà Bel, an economist at the University of Barcelona. Centralized control, Mr. Bel told me, is “in the genetics of the Spanish state.”

The example Mr. Bel and others like to use is infrastructure investment, which Spain’s leaders since the 17th century have deployed to affirm their rule and proclaim the Spanish nation. Today Spain, the fifth largest EU member state by GDP and by population, has more international airports and more miles of motorways than any other country in Continental Europe. It has more miles of high-speed rail than any country in the world except China; it also has the lowest ridership per mile of high-speed rail in the world. More miles of high-speed rail are currently under construction in Spain than in all other EU countries combined.

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Fast trains to nowhere are emblems of government folly the world over. But Spain’s centralizing impulse runs deeper than most, Mr. Bel says. Ever since the 18th-century
Bourbon kings, Spain’s leaders have sought to make their state in France’s image: strongly unified, with power amassed at the center and all roads (or rails) extending outward from the capital.

But the Iberian kingdoms’ strong cultural and historical identities meant that yoking them together has created continued unease. Spain’s rulers made “a bad copy” of France, said Ferran Requejo, a political scientist at Pompeu Fabra University, when we met last week.

Even a facsimile shares some characteristics with the real thing. In Spain, Mr. Bel says, “Any type of economic reforms that increase flexibility and uncertainty will be heavily resisted.”

“This was the case, for instance, in the case of [February’s] labor reform. They didn’t significantly change the way in which collective bargaining is conducted. Firms can decrease wages, but still the collective bargaining is at the provincial level... This is going to be bad two or three years from now.”

Is it unfair to take Madrid’s attitude toward the regions as a weathervane for its ability to undertake structural reforms generally? Throughout Europe, politicians are discovering the limits to governing from the center during a crisis. There are rigidities associated with concentrated authority, but there are also important questions of legitimacy and shared cause.

“The fact is,” Mr. Bel says of Catalonia and Spain, “there is a sense of being different nations.” Under strain, the EU is learning that it, too, is made up of different nations. Brussels could use its own Catalanian thorn in its side: a reminder that nations are not just vehicles for paying off their governments’ debts.

—Mr. Zhong is an editorial page writer for The Wall Street Journal Europe.