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Putting Madrid back on track

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Ever since his election, the Spanish prime minister, Mariano Rajoy knew that the economic travails of 2011 had left a long shadow on his country's public finances. Just how long this shadow really was became clear this week. The public sector deficit reached 8.5 per cent of gross domestic product. This is above both the six per cent target agreed with the EU and an eight per cent estimate made by the government in December.

This further downward revision is not, per se, worrying. At 67.8 per cent of national income, Madrid's public debt is one of the lowest among developed economies. But the new figures raise doubts over whether the country will be able to hit the EU deficit target for 2012 of 4.4 per cent of GDP.

To reach it, Mr Rajoy would have to impose at least €25bn of cuts or tax rises, which would be in addition to the €15bn package announced last December. The new measures would increase the rate at which Spain will shrink next year. This may reduce tax revenues and increase the risk that, in spite of the extra effort, Madrid misses its target anyway.

It is therefore unsurprising that Mr Rajoy is reportedly pressing the EU to increase Spain's deficit target to above 5 per cent. Rather than insisting on excessive austerity the Commission should agree with Madrid's reasonable demands.

Since Mr Rajoy has come to power, Spain has passed a range of overdue reforms. It has demanded that the banks clean up their balance sheets without additional help from Madrid. This month it has unveiled a comprehensive labour market reform which should boost productivity and lower labour costs.

The reform makes it much easier for firms to opt-out of industry-level collective agreements, which have made it hard for small-sized firms to adjust wages and hours to accommodate adverse shocks. And while the government did little to clamp down on the excessive use of temporary contracts by firms, it was right to reduce the level of severance pay for permanent contracts, which was well above the European average.

As last Sunday's protest marches showed, these reforms will cause some discontent among those privileged workers on permanent contracts. But the government can hope for the support of those who are not in this happy place. Too tight a second round of belt-tightening would put Mr Rajoy and his government in a more difficult position. Brussels would be unwise to disregard politics and so follow misguided economics.

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