

Inside Spain, N° 1 (1 April 2004)

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The blasts on four trains that killed 190 people in Madrid not only brought Islamist terrorism to Europe on a massive scale but also radically changed Spain's political map and reshaped European politics. As the victims were being buried, Spaniards flocked to the polls in unprecedented numbers, in a magnificent display of support for democracy and defiance of the terrorists, and voted out the centre-right Popular Party (PP) which had been in power for eight years. The Socialists' victory took everyone by surprise, including the winning party, but in retrospect it was not that surprising. As Harold Wilson, a former British prime minister, said, 'A week is a long time in politics.' Spain's week, with the general election three days after the trains were blown up, was an extraordinary one by any standards. In another well-worn dictum, the former British premier, Harold Macmillan, said that politics were shaped by what he called 'events'; Spain's were exceptional.

The Socialists won 164 seats in the 350-seat parliament and 10.9 million votes, up from 125 and 7.9 million, respectively, in 2000 and a record number of votes for the party (see Table 1). As they did not win an absolute majority, they will have to govern with the support of small regional parties. But they are in a comfortable position as they can seek allies to their right (the Catalan CiU and the Basque Nationalist Party) or to their left (the Catalan ERC and the United Left) depending on the issue for which they need support. The PP dropped from 183 to 148 seats after losing 700,000 votes. The Socialists' share of the total vote increased from 34% to 42.6% while the PP's declined from 44.5% to 37.6%.

Table 1. Results of Spain's general election, number of seats and percentage of votes

	2004		2002	
	Seats	% of Votes	Seats	% of Votes
Socialists	164	42.6	125	34.1
Popular Party	148	37.6	183	44.5
CiU (1)	10	3.2	15	4.2
ERC (1)	8	2.5	1	0.8
PNV (2)	7	1.6	7	1.5
United Left	5	4.9	9	5.9
Other parties	8	3.2	10	4.0

(1) The CiU and the ERC are Catalan parties.

(2) Basque Nationalist Party.

Source: Interior Ministry.

The Socialists were catapulted back into power, for the first time since 1996, as a result of many factors, one of which was the sharp rise in voter turnout from 68.7%

in 2000 to 77%. This was not far short of the all-time record of 79.8% achieved in 1982 when the Socialists first came to power following the abortive coup of 1981 and the restoration of democracy in 1975 after the death of General Franco. The size of the turnout was as impressive as the 11 million people (more than one in every four Spaniards) who took to the streets all around Spain and demonstrated against terrorism in an outpouring of national grief. These demonstrations highlighted the vigour of Spain's civil society.

Most of the voters who abstained in 2000 were disillusioned Socialists who could not in all honesty vote for the party or cross over to the Popular Party. This time they voted massively for the Socialists along with many of the young people, who voted for the first time. Broadly speaking, these two groups of voters punished the PP for supporting the US in its war against Iraq, the consequences of which were brought tragically home by the devastating terrorist attacks. At the same time, many United Left voters switched to the Socialists because a vote for this minority party was not a 'useful' vote to get rid of the PP.

In a perverse way, the terrorists achieved 'regime change', something that would not happen in the UK, in the same circumstances, because unlike in Spain Tony Blair's support for the war also had the backing of the opposition Conservative Party. It is wrong, however, to interpret the result of Spain's elections as showing that the country is giving in to terrorism. One should not forget that 90% of Spaniards opposed the war against Iraq, according to opinion polls, and that more people demonstrated against it than in any other European country. Also, anti-American sentiment has traditionally been high in Spain for various historical reasons and, furthermore, cuts across the political spectrum. For the first time since the NATO referendum in 1986, foreign policy mobilized demonstrations.

The PP, with a good economic record under José María Aznar (who did not run for a third term), had been predicted to win, according to opinion polls, before the events of March 11, a date indelibly etched on Spaniards' memories to the same extent as September 11 2001 for Americans. It was the worst attack in Europe since the 1988 Lockerbie explosion killed 258 people on a PanAm flight. But then came the deadly blasts and the government blamed them on the Basque terrorist organization ETA too eagerly, although initially there were good reasons to suspect the group (for example, an ETA van travelling to Madrid with half a tonne of explosives was seized a couple of weeks before the attacks).

The PP made successful inroads into ETA during its eight years in office (more than 200 arrests in 2003 and three killings by the group, the lowest number since 1972), but it overplayed the ETA card after the blasts. Spaniards were angry at what they felt was a manipulation of information for the PP's own political benefit, although there was no proof that the government hid information. This anger was vented on the eve of the elections in a series of illegal demonstration outside the PP headquarters. Had ETA admitted responsibility for the deaths, which were roughly the same number as the group has killed since 1990, the PP would have won another absolute majority.

How different will Spain be under the Socialists? One of the first changes is in foreign policy. José Luís Rodríguez Zapatero, the Socialist leader and prime minister-elect, wasted no time in pledging that Spain's 1,300 peacekeeping troops (out of a total multinational force of 154,000) would be pulled out of Iraq by June 30, a central theme of his election campaign. According to Elcano's latest survey of public opinion released in March before the attacks, 40% of Spaniards want the troops home and 40% would accept them staying in Iraq under a UN flag. Zapatero left the door open, however, by saying that their withdrawal depended on whether the United Nations was given a clear

mandate by then to replace the US-led occupation force. The withdrawal of Spanish troops would be militarily insignificant but it would be symbolically important.

The Socialists' victory dealt a blow to the Bush administration, whose 'coalition of the willing' in Iraq largely depended on the willingness of allied governments to risk the wrath of domestic public opinion, and no more so than in Spain. The PP joined the coalition and paid a high price for sticking its neck out. By moving much closer to the US and abandoning its traditional allies, Germany and France, in favour of the UK and Italy, the PP broke the consensus on foreign policy forged since the return to democracy after the death of General Franco in 1975. The main thrust of foreign policy was either oriented towards Europe or emanated from Spain's process of integration into the EU (for example, joining NATO). It should not be forgotten that a previous Socialist government supported the first Gulf War in 1991 and the 'illegal' Kosovo war, and that this enjoyed broad political support and was not massively opposed by society.

The distancing from the US and closer relations with Germany and France will produce an important realignment within the EU. The Socialists are keen to reach a compromise on the new constitution for the European Union. No agreement was reached at the EU summit in Brussels last December, largely, but not entirely, because of Aznar's insistence on keeping the system agreed at the December 2000 Nice summit which was very favourable to Spain. Germany emerged from Nice with no more votes in the Council of Ministers than the next three most populous states, and Spain and Poland were given nearly as many votes as these four, even though there are half as many Spaniards or Poles as Germans. Spain (and Poland) refused last December to accept the proposal of taking decisions by a double majority, composed of 50% of EU states representing 60% of the Union's population. The Socialists are likely to be less intransigent but neither can they be seen to be selling out. The double-majority principle will have to be sweetened in some way.

A related issue, and the one which will have a significant impact on the Spanish economy whatever the outcome, are the negotiations for the 2007-13 EU budget which have already started and have to take into account the enlargement as of May 1 of the EU to 25 countries, all of whom are much poorer than Spain. As the largest beneficiary in absolute terms (€8,400 million net in 2002), Spain stands to be the main loser in the battle on how to distribute these funds. As the party (under the former Socialist prime minister Felipe González when Spain held the EU presidency in 1989) that won the agreement to establish a 'cohesion fund', benefiting the four poorest countries (Spain, Portugal, Greece and Ireland), and an increase in structural funds that would assist not only these countries, but all poor regions in the EU, the Socialists can be expected to put up a strong fight over the funds.

On the domestic political front, the Socialists are as vehemently opposed as the PP was to the plan of the PNV government in the Basque country to hold a referendum over changing the political status of the region to one of 'free association' with the Spanish state. The Basque country already enjoys a much greater degree of autonomy than any other region in Europe; the referendum would open the door to *de facto* independence (the goal of ETA). However the Socialists are prepared to devolve more power to Catalonia, which since last November has been ruled by the Catalan Socialist party and has much less autonomy than the Basque country. The pressure for greater autonomy in Catalonia is also stronger because of the spectacular advance of the Catalan Republican Left (ERC) which increased the number of its seats in the national (Madrid) parliament from one to eight.

On the economic front, Spain enjoyed a bonanza during the eight years of the PP in terms of sustained growth (an average of 3.2% compared with 1.9% for the euro zone as a whole), relatively low inflation (2.1% in 2003), the lowest interest rates ever, a sharp fall in the unemployment rate from 18% to 11% and unprecedented exchange rate stability as a result of joining the euro. Had Spain still been using the peseta its currency would have fallen dramatically after the terrorist attacks. During the PP period Spain's per capita income advanced from 79% of the EU average in 1996 to an estimated 88% in 2004, much better progress than that of neighbouring Portugal, which joined the EU at the same time as Spain in 1986, and Germany which declined (see Table 2). The Socialists inherit a healthier economy than the PP did when it came to power in 1996 (budget surplus of 0.3% of GDP in 2003 as against a deficit of 4.9% in 1996), but its foundations are not solid.

The highly experienced technocrat Pedro Solbes, the EU monetary affairs commissioner and a former finance minister in the mid-1990s during the last Socialist government, will be deputy prime minister in charge of economics and finance. He will head a super-ministry which will join the economics and finance portfolios. Solbes is a firm defender of the EU's stability pact and doggedly pursued France and Germany for breaking it.

Table 2. Per capita GDP convergence (EU-15 = 100)

	1996	2004F
Spain	79.1	88.1
Germany	107.5	99.1
France	101	103.1
Italy	104.2	98.3
Portugal	69.6	69.4

F = forecast.

Source: Eurostat.

The Socialists will maintain the broad lines of the PP's macroeconomic policy including adherence to the pact (budget deficit ceiling of 3% of GDP), but they may be less obsessed than the PP about achieving a balanced budget. They will also put more emphasis on reducing inflation than on growth for growth's sake as one element of its plan to boost Spain's ailing productivity (virtually zero growth under the PP). Inflation has been growing by one percentage point above the euro zone average for some years and this, coupled with the failure to improve productivity, has led to a loss of competitiveness (see Table 3). According to Miguel Sebastián, who coordinated the Socialists' economic programme, if the pace of productivity growth prior to the PP had been maintained Spain's per capita income today would be 95% of the EU average.

Table 3. Ranking of world competitiveness (out of 30 countries)

	2003	1999
US	1	1
Spain	9	7
Germany	5	4
France	8	8
Italy	17	13

Source: IMD World Competitiveness Yearbook 2003.

One factor behind the productivity problem is that one in every three workers is on a temporary contract (by far the highest level in the EU), and this job precariousness does not create the right environment for investment in human capital. The conundrum for the Socialists is how to increase productivity without also increasing unemployment in what is still a fairly rigid labour market. The PP backed down from further labour

market reforms and one test of how liberal the Socialists are will be whether they tackle further reforms. We could be in for surprises. The PP was not really an actively liberal government in economic policy, despite all its rhetoric, and it interfered politically in companies, particularly the large ones after they were privatized. Spain is ranked 27th in the 2004 Index of Economic Freedom drawn up by the US Heritage Foundation.

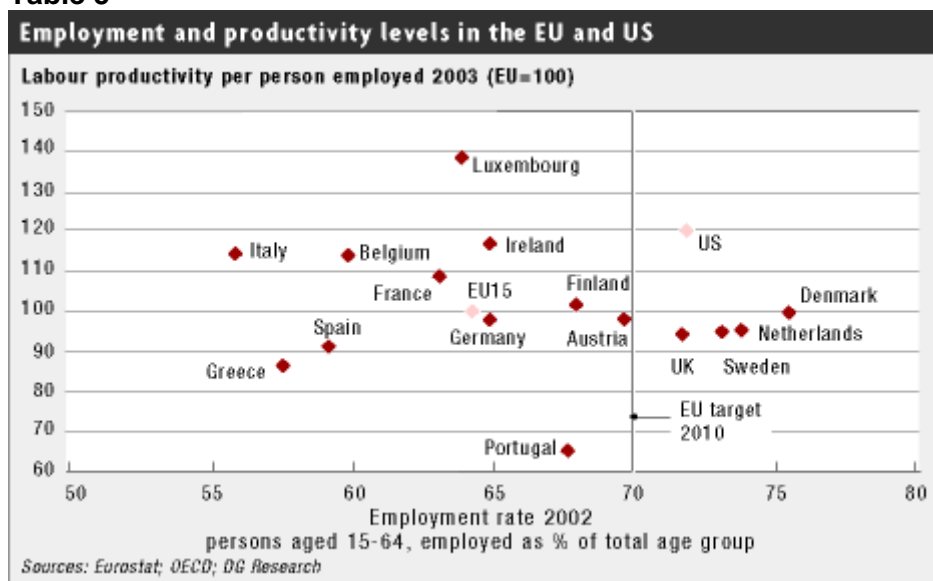
Spain's economic model, based to some extent on low cost jobs, is losing steam, as exemplified by the increasing relocation of foreign companies to new EU member countries whose labour costs are much lower than Spain's. As well as bolstering productivity, the Socialists will try to change the economic model by boosting investment in R&D and education, areas where Spain, the world's eighth largest economy, is lagging way behind (see Table 4). Spain is the only OECD country that spends more on lotteries (1.8% of GDP) than in R&D. The country has made little progress in the Lisbon Agenda which aims to make the EU 'the most competitive and dynamic knowledge-driven economy by 2010' (see Table 5).

Table 4. R&D spending (% of GDP)

	2002
US	2.8
Spain	1.0
Finland	3.5
France	2.2
UK	1.8

Source: Eurostat.

Table 5



A major driver of the economy has been the construction boom (700,000 new homes in 2003, more than Germany and France combined). Low interest rates and a plentiful supply of cheap mortgages have helped to fuel the boom and with it house prices have soared and are now beyond the reach of many young people. The average price per square metre rose from €674 in 1996 to €1,511 in 2003, roughly six times faster than the increase in wages. Whereas a home cost four times an average annual salary in 1996, today it costs seven and a half times. As a result, the level of household indebtedness is high, a dangerous situation if the property bubble bursts.

House prices are now a major social issue in Spain, and even more so for immigrants. The number of legal immigrants (ie, with residency permits) tripled to 1.6 million over the last eight years, and there are at least another 500,000 illegal immigrants. The terrorist attacks revealed the extent of Spain's recent multicultural society: there were a dozen nationalities among the dead, and they were commuters and not tourists. If immigrants cannot buy homes at reasonable prices, they will become permanently marginalized with all the potential negative consequences. On immigration, the Socialists will seek a 'national pact' to take the issue out of the political arena.

The Socialists plan to create a Housing Ministry in a bid to make the market more accessible, through land policy changes among other elements, and establish a Rental Agency to foster a rental market which is still very underdeveloped in Spain. There are a very large number of empty flats, many of them bought just as an investment, which could be rented if the right incentives were provided.

The Socialists will also simplify the tax system further in a bid to crack down harder on tax evasion, which is estimated by the Fiscal Studies Institute at €60bn a year, or about 10% of GDP. Tax returns for 2001, the latest available figures, show that fewer than 100,000 people declared gross incomes of more than €96,000. The reforms could include moving the top personal income tax rate (45%) closer to the corporate rate (35%) in order to discourage the rich from creating companies in order to pay less tax, and better treatment of low incomes.

Lastly, the Socialists have an historic opportunity to depoliticise RTVE, the state-run TV which has two channels. Every ruling party, before it took office, promised to do so but the temptation to wield influence proved too great once it was in power (RTVE's main channel has a 23% audience share). The Socialists have appointed a committee to reform the RTVE statute and create a BBC-style channel. Whether they do or not will be a good litmus test of Zapatero's desire to 'govern for all Spaniards'.

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