



## **Inside Spain N° 4 (5 July 2004)**

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### **Spain makes concessions over the European Constitution**

*The government narrowly wins the election for the European parliament*

The Socialists did not achieve their ‘non-negotiable’ goal of a double majority voting system based on 50% of states representing 66.6% of the EU population in order for measures to be approved by the EU Council of Ministers, but the qualified majority formula that won the day –55% and 65%– was not that far off and it was clearly more in Spain’s interests than the one proposed in the draft constitution (50% and 60%).

The previous centre-right Popular Party (PP) government of José María Aznar, along with Poland, refused to support the 50%/60% formula and were blamed for the acrimonious failure of the December 2003 summit in Brussels. The PP never spelled out its formula, but it was basically the one the Socialists put forward. And as José Luis Rodríguez Zapatero, the prime minister, did not get his way, the PP was quick to criticise the government for blundering in the talks and reducing Spain’s influence. Spain also did not get a firm commitment for more seats in the European Parliament. When the EU expanded from 15 to 25 members in May and European elections were held in June, Spain’s number of seats dropped from 64 to 54, a figure that was not changed at the June summit. There is a chance, however, that Spain may recover a couple of these seats.

Zapatero could not afford to wreck the summit by doggedly sticking to his position on the qualified majority, particularly after Poland had relented. It would not have sat well with his much proclaimed policy of being more pro-Europe (see previous Newsletters) and it would not have won the government any sympathy from the EU’s heavyweights when it comes to negotiating the amount of cohesion and structural funds, if any, that Spain receives for the 2007-13 budgetary period.

Under the old system of weighted votes (which was extended under the Nice treaty in December 2000 to embrace the new EU members), the big countries were at a disadvantage. Germany, for example, accounted for 22% of the EU-15 population but just 11.5% of votes on the Council of Ministers. Spain, on the other hand, had almost

the same number of votes as much more populous Britain, France, Germany and Italy. It was an untenable position that could not be reasonably defended.

The qualified majority formula proposed by the Socialists would have maximised Spain's power, although it would also have considerably improved that of the other large countries. The higher the population threshold is raised the more the power of France and Germany would have also risen.

Miguel Ángel Moratinos, Spain's foreign minister, said the 55%/65% formula increased the country's number of possibilities of forming coalitions to influence or block decisions by five compared with the proposal in the draft constitution of 50%/60%. On top of this, there is a provision that a blocking minority must come from four or more countries. This makes it easier for Spain to block laws it does not like.

All 25 countries have to ratify the constitution, either through parliamentary votes or through referendums. Spain will be one of the first countries to put the constitution to a vote in a referendum.

#### *The government narrowly wins the election for the European Parliament*

The Socialists repeated their March general election victory in the elections for the European Parliament, but by a much narrower margin than opinion polls had predicted. They edged out the Popular Party (PP) by only two percentage points, winning 25 of Spain's 54 seats in the new parliament as against the PP's 24 (see Figure 1).

**Figure 1. Results of European Elections, 2004 and 1999**

	2004 Seats	2004 Votes	2004 % of votes	1999 Seats	1999 Votes	1999 % of votes
Socialists	25	6,741,112	43.3	24	7,477,823	35.3
Popular Party	24	6,393,192	41.3	27	8,410,993	39.7
Galeusca <sup>1</sup>	2	798,816	5.1			
IU-ICV	2	643,136	4.1	4	1,221,566	5.7
EP <sup>2</sup>	1	380,709	2.5			
CE <sup>3</sup>	-	184,575	1.2			
CiU				3	937,687	4.4
CE <sup>4</sup>				2	677,094	3.2
CN <sup>5</sup>				2	613,968	2.9
BNG				1	349,079	1.65
EH				1	306,923	1.4
Turnout (%)			45.1			63.1
Total	54			64		

(1) Coalition of Catalan, Basque and Galician nationalist parties.

(2) *Europa de los Pueblos*.

(3) *Coalición Europea*.

(4) *Coalición Europea* in 1999.

(5) *Coalición Nacionalista* in 1999.

Source: Interior Ministry.

Turnout reached a record low for Spain's democracy of 45% –down from 77% for the general election and 63% in the last European elections–. Spain's experience is that the higher the turnout the more it benefits the left, as the recent general election most clearly showed (see *Inside Spain*, Newsletter 1, April 1, 2004), and the higher the abstention rate the more it works to the advantage of the PP. Coming so soon after the general election, the Socialists' victory in the European election was generally regarded as a foregone conclusion and partly explains the low turnout.

The turnout for European elections in all countries is always lower than that for general elections, partly because voters feel these elections do not affect their lives to anywhere near the same extent. Spain's turnout was just above the average of 45.5% for the EU-25 (Belgium was the highest with 90.8% and Slovakia the lowest with 16.6%).

The Socialists had reason to feel satisfied with the result. Yet it was hardly the sweeping victory they were hoping to receive in order to show that the one in March was not a fluke and due, to a significant extent, to the impact of the Islamist terrorist bomb blasts on a population widely against the war with Iraq (which the previous PP government supported). The PP narrowed the gap with the Socialists from five points to two (see Figure 2). On the other hand, the European election in which less than half of voters went to the polls cannot be fairly compared with the general election where three out of every four people voted, and in exceptional circumstances.

**Figure 2. Socialists and PP: Comparison of European and General Election Results, 2004**

	European votes	General votes	% of votes European	% votes General
Socialists	6,741,112	11,026,163	43.3	42.6
Popular Party	6,393,192	9,763,144	41.3	37.7
Turnout (%)			45.1	75.7

Source: Interior Ministry.

Moreover Spain was one of the few to buck the anti-establishment trend widely manifested in the European elections. Voters in the great majority of countries delivered a heavy protest against the parties in power. In all but four countries the ruling party was trounced. In Spain's case (and Greece) this did not happen probably because the government is still enjoying a honeymoon and has yet to take any unpopular decisions. The decisions so far –pulling out Spain's troops from Iraq, raising the minimum wage as of July and giving more state scholarships to students– could but only win support.

The European elections also showed a greater degree of polarization between the two main parties. The Socialists and the PP between them took close to 85% of the total votes compared with 75% in 1999. This polarization was at the expense of the United Left (IU) and nationalist parties. The United Left has been steadily declining since 1999: it won 1.3 million votes in the 1999 European elections, 1.2 million in the 2004 general elections and 643,000 in the European elections.

The nationalist parties grouped together for the European elections to a much greater extent than in 1999. The CiU (which ruled Catalonia for 23 years until it lost to the Catalan Socialists in 2003), the Basque Nationalist Party (still ruling the Basque Country) and the Galician BNG ran on the same ticket with other parties under the Galeusca banner. Nationalist parties overall captured 8.9% of the vote, down from 12% in 1999. The biggest loser was the centre-right CiU which won 64% fewer votes than it did in last year's regional elections in Catalonia. Overall CiU and the Catalan Republican Left (ERC), which is the minority partner of the Socialist Catalan government, won 29% of the vote, down from 48% in the regional elections.

#### *Government names senior diplomat to be ambassador to the US*

The government named Carlos Westendorp as its new ambassador to the US. Westendorp, a former foreign minister (1996), ambassador to the European Union (1985-91) and the EU's High Representative in Bosnia and Herzegovina (1997-99), will be the most senior Spanish diplomat to hold this post.

His appointment, which needs the placet of Washington, underscores the importance the Socialists attach to patching up relations with the US, which have deteriorated since the withdrawal of Spanish troops from Iraq. Westendorp is not only an experienced diplomat but

also a member of the Socialist party (he was a member of the European parliament) and so has good political connections. He is to replace Javier Rupérez, a former member of parliament for the Popular Party, who is going to be the executive director of the UN's Antiterrorist Committee.

*Spain already surpasses the threshold for EU cohesion funds*

Spain, in theory, no longer qualifies for EU cohesion funds as its per capita GDP already surpasses the threshold of 90% of the EU average, according to the first 'nowcasts' expressed in terms of the EU-25 average (see Figure 3) by Eurostat, the EU's statistics arm. These funds are worth €11,160 million for Spain in 2000-06. The crunch will come in 2007 when the next budgetary period begins.

The entry as of May of 10 new EU countries, most of which are much poorer than the EU-15, has sharply reduced the average per capita GDP. As a result of this 'statistical effect', Spain's per capita GDP has moved from 87% of the EU-15 average to 95% of the EU-25 average. Eurostat emphasises that this is a preliminary figure. The definitive one will not be published until the end of 2005, but there is no way it will drop to below the magic figure of 90%.

This statistical exercise will also affect the amount of funds that Spain's poorest regions receive. At present, Objective 1 regions such as Extremadura, Andalusia and Galicia whose per capita GDP is less than 75% of the EU average receive structural funds (€45,000 million for Spain in 2000-06).

**Figure 3. Per capita GDP of EU25 in 2003 in Purchasing Power Parities (EU-25 = 100)**

Country	Country	
Luxembourg	208	Cyprus
Ireland	131	Slovenia
Denmark	123	Greece
Austria	121	Portugal
Netherlands	120	Malta
United Kingdom	119	Czech Republic
Belgium	116	Hungary
Sweden	115	Slovakia
France	113	Estonia
Finland	111	Lithuania
Germany	108	Poland
Italy	107	Latvia
<b>Spain</b>	<b>95</b>	

Note: purchasing-power parity rates give a more accurate comparison of living standards than market exchange rates as they reflect price differentials between countries.

Source: Eurostat.

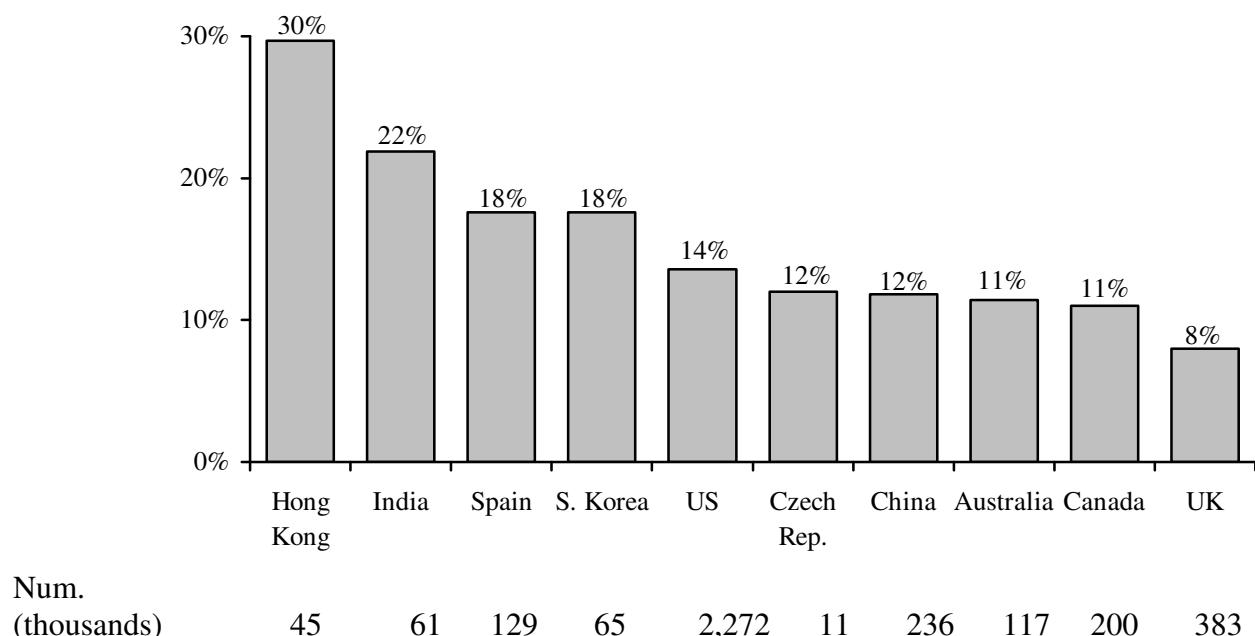
Two insightful and recently published books on Spain –*Spain and the European Union* by Carlos Closa and Paul Heywood (Palgrave) and *Spain: A Modern European Economy* by Joseph Harrison and David Corkill (Ashgate)– are a timely reminder of just how well Spain as a whole and some regions, in particular, have done from EU funds. Heywood, professor of European politics at Nottingham University, and Closa, professor of political science at Zaragoza University, point out that Spain could have become a net contributor as early as 1993 if the Socialist government of Felipe Gozález had not managed to persuade Brussels to design a cohesion fund that was tailored to suit Spain's needs. Eleven years on and Spain is still a net receiver. This fund alleviated the paradoxical situation whereby the most developed Spanish regions could not receive regional funds under Objective 1, although almost all of them had below EU-average income. Their book is a scholarly review of all the many EU aspects that have affected Spain and how this has shaped the political process in the country. They conclude, rightly in my view, that EU membership is itself Spain's national project, and even more so now with the more overtly Europeanist government.

Harrison, senior lecturer in history at Manchester University, and Corkill, professor of Iberian studies at Manchester Metropolitan University, survey the different sectors of the economy and also look at trade, foreign investment and demography. They succeed in their mission of dispelling the old stereotypes that still persist, despite the fact that Spain is now the world's eighth largest economy, and show just how rapid and profound economic modernization and structural transformation have been.

#### *More euro millionaires*

Further evidence of the inexorable rise in Spain's wealth came from the 2004 World Wealth Report, published in June by Merrill Lynch and Capgemini. Spain registered the world's third largest rise in 2003 in the number of high net worth individuals with more than US\$1 million (€833,000) in liquid (ie, readily available) financial assets (see Figure 4). The number rose by 18% to 129,000. Spain's growth was well above the European (2.4%) and the world (7.5%) averages. Spain is the only euro zone country in the ranking. The surge was due to Spain's sustained and high economic growth (and lower income taxes), the upturn in its domestic financial markets and the booming real estate market. Such figures provide ammunition for those on the left who believe the previous government's tax reforms mainly benefited the rich. The Socialists, however, are committed to not reversing the tax reforms and perhaps will reduce tax rates further.

**Figure 4. Top 10 Countries with the Highest Growth in the Number of High Net Worth Individuals (% Rise over 2003 in Individuals with More than US\$1 Million)**



Source: Merrill Lynch, Capgemini, World Wealth Report 2004.

#### *Spain's FDI falls at home and abroad, but less than other countries*

Spain's inward and outward foreign direct investment (FDI) stood up well in 2003 compared to many other OECD countries which registered much steeper declines. The inflow dropped 28% to US\$25.6 billion and the outflow declined 25% to US\$23.4 billion (see Figure 5). FDI flows into the UK, for example, fell by almost half in 2003,

from a level that was already unimpressive by historical standards, while France's changed very little and were three times those of Germany and the UK.

However, some caution is called for in Spain's figures. The expansion of foreign securities holding companies (known as ETVEs in Spain) is believed to have boosted gross FDI flows from and to Spain. This problem also affects other countries.

**Figure 5. Direct Investment Flows To and From Selected OECD Countries, 2000-03 (US\$ Billion)**

	Outflows				Inflows			
	2000	2001	2002	2003	2000	2001	2002	2003
France	177.5	86.8	49.5	57.3	43.3	50.5	48.9	47.0
Germany	56.6	36.9	8.6	2.6	198.3	21.1	36.0	12.9
Ireland	4.6	4.1	3.1	1.9	25.8	9.7	24.4	25.5
Italy	12.3	21.5	17.1	9.1	13.4	14.9	14.6	17.0
Portugal	7.5	7.6	3.3	0.1	6.8	5.9	1.8	1.0
<b>Spain</b>	<b>54.7</b>	<b>33.1</b>	<b>31.5</b>	<b>23.4</b>	<b>37.5</b>	<b>28.0</b>	<b>35.9</b>	<b>25.6</b>
United Kingdom	233.5	58.9	35.2	55.3	118.8	52.7	27.8	14.6

Note: (p) preliminary; (e) estimate.

Source: OECD.

In net terms (outflows less inflows), Spain was ranked seventh in the world for the 1994-2003 period (see Figure 6). The latest major investment abroad by a Spanish company was the purchase by Repsol YPF of Shell's 303 service stations in Portugal, which almost quadrupled Repsol's market share to 19%.

**Figure 6. Net Outflows, 1994-2003 (US\$ Billion)**

Country	
United Kingdom	415.6
France	301.0
Japan	217.6
Switzerland	108.5
Netherlands	96.3
Germany	65.6
<b>Spain</b>	<b>46.7</b>

Source: OECD.

#### *Budget stability law reformed*

The government, with the support of other parties as the Socialists do not control parliament, reformed the PP's budget stability law which came into effect in 2003 and commits the authorities to a balanced overall budget every year. However, the economy czar, Pedro Solbes –who as the former EU monetary affairs commissioner was a firm defender of the EU's stability pact and doggedly pursued France and Germany for breaking it– made it clear that the aim was still to balance the books.

The new law, which will come into effect as of 2006, will allow the autonomous regions' budgets to be calculated according to each one's specific needs, with the deficits of some offset by the surpluses of others. The Socialists' philosophy is to achieve a balanced budget over the course of an economic cycle and not every year regardless of the health of the economy. The new mechanism, however, will not be as efficient as the previous one for controlling spending. The social security accounts will also be shown separately and not as part of central government, thereby increasing transparency. Spain generated a small overall budget surplus in 2003 thanks to the buoyant social security accounts.

### *Bank of Spain warns on house prices*

Jaime Caruana, the governor of the Bank of Spain, urged house buyers and sellers to act cautiously as the ‘overvaluation’ of these assets was not corrected in 2003 and there was a need for ‘an ordered adjustment through a slowdown in prices.’ He also said that household debt, most of it mortgages, ‘cannot grow indefinitely at the rapid pace of recent years.’

Caruana was presenting the central bank’s annual report on the Spanish economy. He also added his voice to the need for Spain to improve its very low productivity growth. Productivity is one of the economic buzzwords of the government. According to a recent study by Guillermo de la Dehesa, chairman of the Centre for Economic Policy Research, the average annual growth of Spain’s productivity as measured by per person employed was 0.5% between 1996 and 2002 compared with 1.2% for the EU. When measured by per hour worked it was even worse at -0.4% as against 1.2%.

While low productivity gains can be explained in terms of Spain’s very strong job creation (4.5 million jobs in 10 years, one-third of the total for the EU-15) and of a composition of growth which, in recent years, has been largely based on construction and on services, Caruana said they nevertheless reflect low productive investment, a limited incorporation of technological improvements and the relative lack of competition in certain segments of the economy.

### *Shock plan for paperless immigrants*

The sit-in by several hundred immigrants in Barcelona’s cathedral highlighted the growing problem in Spain of immigrants without residency papers or work permits. The government said it would use its INEM unemployment offices to sort out the backlog of more than 370,000 people who applied for their papers months ago under the previous government.

Spaniards are becoming increasingly concerned about the number of immigrants. According to the latest survey by the government’s Centre of Sociological Research (CIS), 53.3% of Spaniards believe there are too many immigrants compared with 47.8% a year ago. Eight-five per cent said they were in favour of a system that only allowed immigrants (ie, non-EU ones) to enter the country if they came with a labour contract. The latest estimate by the National Statistics Institute (INE) for the total number of legal and illegal immigrants is 3.3 million (7.5% of the population).

### *Plenty of rain on the plain*

Spain’s lakes are at their highest levels in the past 10 years, thanks to an abundance of rain. This augurs for a good harvest. A substantial proportion of Spain’s agriculture depends on irrigation with water from lakes. A strong harvest would help ease food prices and lower Spain’s inflation, which reached an annual rate of 3.4% in May, its highest level since March 2003 and largely because of the sharp rise in oil prices.

Meanwhile, the decision to pull the plug on the previous government’s national water plan, under which water from the traditionally ‘wet’ north would be transferred 300 miles south to the ‘dry’ south, has left many construction firms in Valencia, Alicante and Almería high and dry. Companies and international investors including George Soros went ahead with ambitious plans for tourism complexes, holiday homes and golf

courses on the assumption that the PP would be re-elected. They were marketing the region as a new Florida.

About 100,000 holiday homes and 10 golf courses received planning permission in Almería and a further 34 golf courses each using as much water as a town of 10,000 people, were approved in Murcia.

The government's water plan centres on building more desalination plants on the east coast, which already has Europe's biggest reverse osmosis desalination plant at Carboneras, owned by a subsidiary of the UK's Thames Water. There would also be different prices depending on use. The highest price would be for golf courses (up to 10 times more).

As a result of gross mismanagement of water resources, Murcia's aquifers are already drying up because twice as much water as was prudent has been extracted.

The quality of Spain's coastal waters has improved, according to the annual EU quality of bathing water survey, although it noted that Spain had removed polluted inland bathing areas (lakes and rivers) from the survey rather than tackling the source of the problem. This raised eyebrows at the European Commission. Since 1994 Spain has cut the number of monitored sites by 65%.

#### *World's sixth largest car producer*

Spain was the world's sixth largest car producer in 2003 and its growth in output was the highest of the top 10 producing countries (see Figure 7). The country's global market share reached close to 6%. Exports are very much the key to Spain's success –in 2003 they represented 82% of total production compared to 50% in 1987, one year after joining the EU–.

**Figure 7. World Car Production**

Country	Units (millions)	% of world total	% change 2002
Japan	8.4	20.1	-1.6
Germany	5.1	12.2	0.4
United States	4.5	10.7	-10.1
France	3.2	7.6	-2.2
South Korea	2.7	6.6	4.4
<b>Spain</b>	<b>2.4</b>	<b>5.7</b>	<b>4.8</b>

Source: International Car Manufacturers Association.

#### *Spanish satellite to provide total coverage for Latin America*

Hispamar, a joint venture between Brazil's Tele Norte Leste and Spain's Hispasat, will launch in July the first satellite to provide total telecommunications coverage for Latin America.

The satellite can handle nearly 250,000 phone calls at the same time and provide services such as digital TV, wireless and Internet.