

Inside Spain 11

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Foreign Policy

Spain votes for the European Constitution, but with a low turnout

Spain became the first country to approve the European Union constitution by referendum, but the turnout was only 42.3%, the lowest participation in all of the country's plebiscites since the restoration of democracy in 1975. The referendum was carried by 76% in favour, 17% against and 6% blank votes.

The constitution must be ratified by all 25 EU member states, either in a referendum or a parliamentary vote, by November 2006. José Luis Rodríguez Zapatero, the prime minister, was very keen to press home his pro-European credentials and claim credit for the first victory in a referendum, but the low turnout hardly set a shining example, as had been hoped, for the other nine countries whose governments will hold referendums.

Both the Socialists and the centre right Popular Party (PP) campaigned for a 'Yes' vote, as befits a country that has benefited hugely from EU membership (Spain is the largest net recipient of funds and membership has anchored democracy), but both parties tried to score points off one another and hug the limelight. And as soon as the results were announced, the PP immediately pinned the blame on the Socialists for the low turnout.

Although Spaniards overwhelmingly approved the constitution, nine out of every 10 surveyed before it said they knew little or nothing about it. The government spent € million on a glitzy media blitz, enlisting the support, among others, of former soccer heroes Emilio Butragueño and Johan Cruyff and Pedro Duque, Spain's only astronaut, and distributing 800,000 copies of the constitution. It is a moot point whether the turnout would have been much higher had the government allowed more time for the referendum. Nevertheless, it could have been less hasty and made a greater effort to explain the content of the constitutions and its consequences.

Referendums also tend, depending on the issue, to become a vote for or against the government of the day rather than on one specific matter. And the issue at stake in this referendum was one which, in all EU countries, is not felt to have a direct impact on lives. Voter turnout in Spain's European elections last June was only 45%, not much more than the level of participation in the referendum on the EU constitution, and

compared with 77% in the March general election (which was high for exceptional reasons).

The government was also not helped by the Roman Catholic Church. In a departure from its usual position of encouraging people to do their civic duty and vote, Father Martínez Camino, the spokesman for the Spanish bishops' conference, said abstention was 'legitimate when it is not possible to overcome the complexity (of the issue) or for people who do not agree with the conditions in which the referendum is being organised'.

The vote by regions and municipalities shone an interesting light on Spain's complex political configuration. A large percentage of 'No' votes, significantly higher than the national average, were registered in the Basque Country (33.6%) and Catalonia (28%), precisely those regions demanding the greatest autonomy from the central government. The level of abstention in the Basque Country was 62%, well above the national average of 57%. This region's government is on a collision course with Madrid over its planned referendum to establish a 'free association' with Spain, opening the door to independence (see *Inside Spain*, Newsletter 10, February 7, 2005).

Some strongholds of the PP in Madrid used the referendum to express their discontent with the Socialists. Although the party line was to vote 'Yes', in some areas the 'No' vote was 30%.

Rodríguez Zapatero addresses the French parliament and urges 'Yes' vote in referendum on EU constitution

Prime Minister José Luis Rodríguez Zapatero addressed a special session of the National Assembly in Paris and used it as a platform to promote a 'Yes' vote in the upcoming French referendum on the European Union's new draft constitution. His presence underlined the growing sense of urgency in the French government on the referendum, which, unlike in Spain, it is far from certain will produce the desired result.

French President Jacques Chirac is expected to call a referendum on the EU constitution in May or June. Polls suggest that the 'No' camp is gaining strength but still lags behind those who would vote 'yes'.

Rodríguez Zapatero was the first Spanish prime minister to address the Assembly and only the 14th foreign dignitary to do so. Others have included British Prime Minister Tony Blair, German Chancellor Gerhard Schroeder and former US President Bill Clinton.

Gibraltar tax change pleases Spain

The UK government has agreed to phase out controversial tax-breaks for companies in Gibraltar, one of the long-running disputes between Madrid and the Rock, a territory which Spain claims.

At the same time, three-way talks in Malaga on the future of the British colony concluded with an agreement to establish a working group to study future joint use of Gibraltar's airport. Both moves were seen in Madrid as the fruits, to some extent, of its policy of wooing Gibraltar rather than antagonising it by aggressively pursuing its centuries-old sovereignty claim (see *Inside Spain*, Newsletter 7, November 4, 2004).

The European Commission declared in January that tax-breaks were a form of illegal state aid and gave Britain four weeks to accept an end to what is known as the exempt company scheme. Spain has long complained of the 'unfair' competition from companies on its doorstep.

Gibraltar's airport is considered British, and Spain does not allow planes landing there to take off for resort destinations in southern Spain. Opening up the airport to international use would benefit the tiny Gibraltarian economy as well as resorts on the Costa del Sol.

Although the atmosphere between the three sides has greatly improved, there are still ripples of discontent that flare up from time to time. Spain's continued annoyance over Britain's use of Gibraltar for repairing nuclear submarines was aired at the meeting.

Bono and Rumsfeld agree to convene the High Level Bilateral Defence Committee
José Bono, the Defence Minister, and his US counterpart Donald Rumsfeld, met on the margins of the meeting of NATO Defence Ministers in Nice and agreed to convene the High Level Bilateral Defence Committee at ministerial level before June. It would be the first time that this Committee meets at ministerial level since 2001.

The move was interpreted as another warming in the relation between the two countries, which deteriorated in 2004 after Spain withdrew its troops from Iraq. Madrid agreed earlier this year to play a more active role in the reconstruction of Afghanistan and deploy troops it has in Kabul in the more conflictive western part of the country (see *Inside Spain*, Newsletter 10, February 7, 2005). Spain will be the main contributor to Nato's new phase of operations in Afghanistan.

President George W. Bush greeted José Luis Rodríguez Zapatero, the prime minister, at the Brussels summit between the US and the EU, with the words, '*Hola, qué tal amigo?*' (Hello, how are you friend?). Spanish commentators poured over the four words which Zapatero said were 'correct, normal and reasonable'.

New development cooperation plan aims to double aid to poor countries
The government aims to double spending on aid to poor countries to 0.5% of GDP in 2008 and to 0.7%, the goal set in 1970 for developed nations, in the next legislature. In a marked departure from the previous plan, aid will be tied more to fighting poverty than promoting commercial interests.

Spain is among the least generous of OECD donors. Only four EU countries –Denmark, Luxembourg, the Netherlands and Sweden– currently meet the 0.7% target.

The Socialists will give greater consideration to writing off debts if the country concerned is prepared to invest the money owed in education or developing important parts of the economy.

The plan was generally welcomed by Spain's NGOs, but they criticised the lack of a specific budget for it and the continued granting of some conditioned aid.

Domestic Scene

Immigration amnesty starts, could benefit up to 1 million people

Spain began the largest ever amnesty for illegal immigrants in Europe. An estimated 1 million illegal residents have until May 7 to regularise their situation, which they can do if they have an employment contract and can prove they lived in Spain for six months before February 7, 2005.

The controversial move, criticised by the centre-right opposition Popular Party and by some EU countries, is aimed at ending the exploitation of migrant labour and increasing tax and social security revenues. German and Dutch officials expressed concern at the impact of Spain's policy on the rest of the European Union because once people obtained residency permits they could freely move to other EU countries.

Madrid's approach was also in sharp contrast to the UK's which at almost the same time announced that it would restrict the arrival and settlement of low-skilled migrants (the category covering the great bulk of Spain's immigrants). More than 48,000 immigrants requested residency permits during the first two weeks of Spain's amnesty.

Spain's foreign population has been growing inexorably and at the end of last July was officially put at 3.1 million (7% of the total population), proportionately more than double that in 2001. Spain accounted for one-third of net migration into the EU in 2003.

The Socialists say they inherited an unsustainable situation and believe their policy is the most humane and economically effective as it will flush out those working in Spain's still large shadow economy. The more people working legally, the larger their contribution to the state's coffers. It is an open secret that many employees are abusing labour market laws and leaving immigrants in a precarious situation, as well as not fully paying their taxes.

The government believes that giving immigrants rights is the first step towards integrating them into a society that has so far been very tolerant of them, largely because they are doing the jobs that Spaniards are no longer prepared to do and are not yet an employment threat (the unemployment rate has declined from 17% in 1997 to under 11%).

The amnesty, however, is attracting a flood of would-be immigrants, from as far away as Rumania, hoping to cash in on the liberal policy. This would only happen if they were able to fake the documents needed or pay bribes for them.

Spain's move led the European Commission to call for greater co-operation on immigration policies. It urged member states to hold consultations on an 'early warning' system for immigration initiatives. Margot Wallström, Vice-President of the Commission, said Spain's policy was 'in line with EU guidelines', thereby indirectly denying reports that the Commission was unhappy with it.

Warning on global warming in Spain as Kyoto Protocol comes into effect

Spain faces a bleak future environment with temperatures of over 50°C (122°F), less rain, a rise in the sea level and the consequent loss of beaches, according to research released by the Environment Ministry. The report coincided with the coming into force of the Kyoto Protocol which aims to slow global warming.

The scientists said that over the last 100 years Spain has warmed up 1.5°C, while the global average has been 0.6°C and the European one 0.95°C. Temperatures have already soared to over 45°C (113°F) in summer and could be up to seven degrees hotter by 2070-2100. Many of the country's beaches could be swamped by the sea rising by 10 to 68 cm (4 to 27 inches). Tourism already generates 12% of Spain's GDP and is a major employer.

Spain's greenhouse emissions in 2004 were 45% higher than in 1990, the reference year under the Kyoto Protocol. The government is committed to limiting the increase in emissions between 2008 and 2012 to 15% higher than in 1990.

The Economy

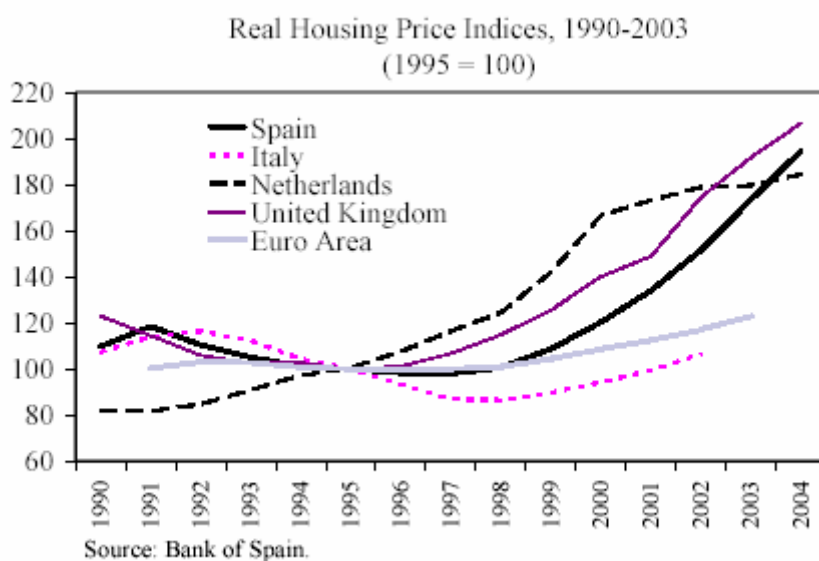
IMF issues favourable report on Spain, warns on house prices

Spain has weathered the economic slowdown in the European Union relatively well, but its inflation differential is still too high, household indebtedness has soared on the back of an ongoing real estate boom and competitiveness has been further eroded. These are some of the main conclusions of the annual report on Spain by the International Monetary Fund (IMF), the first one since the Socialists came to power in April 2004 and since Rodrigo Rato, the economy *supremo* in the last government, became the IMF's managing director (see www.imf.org/external/pubs/ft/scr/2005/cr0556.pdf).

The economy grew 2.6% in 2004 compared with average growth for the 12-nation Euro-zone of around 2%, fuelled by buoyant private consumption and construction. The inflation differential, however, was about one percentage point *vis-à-vis* the Euro-zone average.

The boom in house prices and the sharp increase in household indebtedness continued unabated. With a sixth straight year of double-digit growth in 2004, house prices have virtually doubled in real terms since 1997 (see Figure 1). Mortgage credit –in a country where real short-term interest rates have been negative for three years– surged 25% in 2004. Household indebtedness has overtaken Euro-zone levels, reaching 73% of GDP in 2004.

Figure 1.



The IMF cautioned that the longer the rise in house prices lasts, the greater the potential for an adverse fallout. The Spanish authorities, however, took a more sanguine view and recalled the various fundamental factors driving house prices (historically low real interest rates, lengthened mortgage maturities, Spain's relatively later 'baby boom', high immigration and strong non-resident demand) and saw them as providing a reasonable degree of reassurance of an orderly correction. They thus continued to hold the view that the situation was not yet alarming, but would become so if current trends were to persist. The IMF noted that, with no signs of abatement in underlying trends, this view was becoming more tenuous.

It recommended gradually eliminating tax deductions for the purchase of homes, changes to the legal framework for renting (a very underdeveloped market in Spain) and reforming land laws.

The IMF also urged the government to assign higher priority to comprehensive pension reform, noting the slow progress under the Toledo Pact made so far. Reforms aimed at raising the effective retirement age and strengthening the link between contributions and benefits were needed.

The IMF raised its forecast for Spain's growth this year to 2.7% and envisaged a return to a budget surplus of 0.3% of GDP (see Figure 2).

Figure 2.**Spain: Selected Economic Indicators, 2000-2005 1/**

	2000	2001	2002	2003	2004	2005
Real economy (change in percent)						
Real GDP	4.4	2.8	2.2	2.5	2.6	2.7
Domestic demand	4.6	2.9	2.8	3.2	3.9	3.9
HICP (average)	3.5	2.8	3.6	3.1	3.0	3.5
Unemployment rate (in percent)	13.9	10.5	11.4	11.3	10.8	10.4
Public finances (general government; in percent of GDP) 2/						
Overall balance	-0.8	-0.3	0.1	0.4	-0.8	0.3
Primary balance	2.3	2.6	2.6	2.7	1.3	2.3
Interest rates						
Money market rate	4.4	4.3	3.3	2.3	2.1	...
Government bond yield	5.5	5.1	5.0	4.1	4.4	...
Balance of payments (in percent of GDP)						
Trade balance	-6.2	-5.6	-5.0	-5.1	-6.1	6.8
Current account	-3.4	-2.8	-2.4	-2.8	-4.0	4.6

Sources: IMF, *World Economic Outlook, Information Notice System*; and IMF staff estimates.

1/ Figures for 2003-2004 are Fund staff projections.

2/ Maastricht basis.

Government announces reforms to boost ailing competitiveness

The government announced reforms aimed at reversing the alarming decline in Spain's competitiveness. They include measures to further liberalise the energy and telecommunications sectors, the transport, capital and postal services markets and provide greater incentives for investment in technology. The details of the reforms will be made later in the year.

The Spanish economy has grown over the last decade at a faster pace than the Euro-zone, but inflation has remained consistently higher and the current account has moved from surplus to a deficit of 4% of GDP in 2004. The country has slipped down the main global competitiveness rankings.

According to the economy ministry's calculations per capita GDP grew just 3.9% between 1998 and 2004, compared with 5.4% in the Euro-zone and 16% in the US.

Foreign direct investment in Spain has been falling and some multinationals and Spanish companies have begun to move out and relocate in lower cost nations, particularly the Eastern and Central European countries that joined the European Union last May. There is also a growing trend of relocating in Asia.