

SPAIN, ECONOMICS AND POLITICS IN 2004

Guillermo de la Dehesa, Chairman of the CEPR, Centre for Economic Policy Research

The Spanish economy has proved to be very resistant to the fast deceleration of economic growth of the Euro Area. After growing at an average rate of 4.175 % in the four booming years, from 1997 to 2000, while the Euro Area grew only at an average of 2.875%, that is, 1.3 percentage points less, the subsequent fall in its growth rate has been less pronounced than that of the Euro Zone. In 2001, Spain maintained its 1.3 points of differential growth rate; in 2002, increase it to 1.4 points; in 2003, it is expected to go up to 1.5 points (2% versus 0.5%) and, in 2004, according to "The Economist poll of forecasters" average, it will go down to 0.9 percentage points, given that Spain is expected to grow at 2.6% versus the 1.7% of the Euro Area.

This is without any doubt an excellent relative economic performance, which is going to allow the Spanish GDP per capita, at purchasing power parities, to converge to 85% of the European Union average by 2004, when in 2000 it was only 82%. Moreover, Spain has been able to comply with the Stability Pact rules by achieving a budget balance close to zero in the last four years and, at the same time, to reduce its unemployment rate to 11%, historically, the closest to the Euro Area average, which is at present 9%.

Given that Spain is expected to hold national elections in March 2004, the Popular Party, in power since 1996, has a high probability, leveraging on such a good economic performance, to keep in government for another four years. Prime Minister Aznar has kept his early promise, very rare in European politics and very well perceived by the public, of not standing for reelection after eight years at the head of the government, a decision that his successor as PP candidate, Mariano Rajoy, seems prepared to apply also to himself, adding another political card for further support from the median voter. Aznar successor has been well received by the majority of the citizens, although the procedure for his appointment has not been in line with the Spanish short democratic tradition, based on within party contested primaries.

Mr Rajoy, who has promised to follow the same policies than the previous governments under Aznar, where he has served as minister in charge of relations with the regional autonomies, as minister of education and culture, as minister of interior and as first deputy prime minister, is a subtle, affable, hard working and very flexible and pragmatic politician with, until now, very few enemies, both in his own party and in most of the opposition. As a candidate, he represents a major change from Aznar, who although has been very straight, coherent and efficient all through his time in power, at the same time, has increasingly shown his reserved, authoritarian and prickly personality. Nevertheless, probably thanks to these personal traits, he has succeeded not only in uniting, for the first time in democratic history, the ensemble of the Spanish right and in attracting part of the center right electorate as well, but also in achieving a very professional, motivated and united party that works as a well-oiled machine following his personal command. Will Rajoy be able to keep that unity after Aznar leaves?

On the opposition, the socialist party, which used to have the same kind of motivation, efficiency, unity of action and electoral appealing under the leadership of Felipe Gonzalez, seems now, after eight years in opposition, to be more fragmented, less motivated and without such a clear leadership and unity of command than before. Nevertheless, Jose Luis Rodriguez Zapatero, its new leader, is an attractive, energetic and articulate politician, who has proved to be a good parliamentarian and who, if he is able to mobilize the full support of the group of the

strong and experienced politicians, nationally and internationally, of his own party and to present them as potential members of his government, he could make it very difficult for Rajoy to win or at least to achieve a majority. In the latter case, the necessary PP coalition with other regional parties will be more difficult this time than ever before, given that they seem to be very upset by the certain oblivion and little room for man oeuvre that Aznar has allowed them, once the PP achieved a comfortable majority in 2000. If this is eventually the case, the regional parties could give enough support to the PSOE to achieve a very narrow but sufficient majority. Therefore, although at the moment the PP is the clear favourite to win the March elections, given its impressive economic track record and its likable candidate, there are still many interrogatives, including the results of the regional elections in Madrid and Catalonia, to be cleared away.

But, whatever are the results of the general elections, the true fact is that present apparent soundness of the Spanish economy hides important weaknesses, which could make the actual growth trend unsustainable in the medium term.

First, its GDP growth composition is worrying. Domestic demand is growing at almost one percentage point above GDP, fuelled by the ECB too expansive monetary policy for Spain, (not so for Germany, France and Italy) compensating for the growth drag by the external demand, where imports of good and services have kept growing faster than exports. Moreover, private and public consumption have been the locomotives of domestic demand, while capital formation has been showing negative growth until mid-2003. From the supply side, the building and construction sector has been the main pillar of growth for some years. More than half of the positive differential growth rate of the Spanish economy with the Euro Area is due to the fast growth of this sector, fed by the large investment in infrastructures by the public sector and by the increasing demand of housing by the private sector. The large drop in interest rates and in public debt service, more than five percentage points since 1995, and the net transfers received by the European Union have allowed the public sector to develop large infrastructure projects, and families to buy massively new houses, profiting by close to zero real interest rates. As a result, forty per cent of the Spanish capital stock is invested today in real estate.

Second, the present model of growth, which is based mainly on labour accumulation and not on labour productivity, is also a matter of concern. While Spain has been by far, since 1995, the leading large European country in terms of employment creation, its productivity growth has been close to zero. According to the International Labour Organization, the Spanish GDP per employed person, in the period 1995-2002, has dropped by 0.4%.

The combination of a fast growth of domestic demand and a very low productivity growth is not sustainable in the medium term, given that it results in both a high rate of inflation and a large current account deficit. On the one side, inflation has kept growing 1 percentage point above the Euro Area average for some years and the low productivity growth has not compensated for that loss of competitiveness affecting exports growth. On the other, that loss allows the pressure of domestic demand to filter to higher imports and an increasing deficit on current account, which could be over 3% of GDP in 2004. Finally, by 2007, Spain could become a net contributor to the European Union finances instead of being a net receiver of around 5 billion euros a year, which can affect negatively its potential rate of growth.