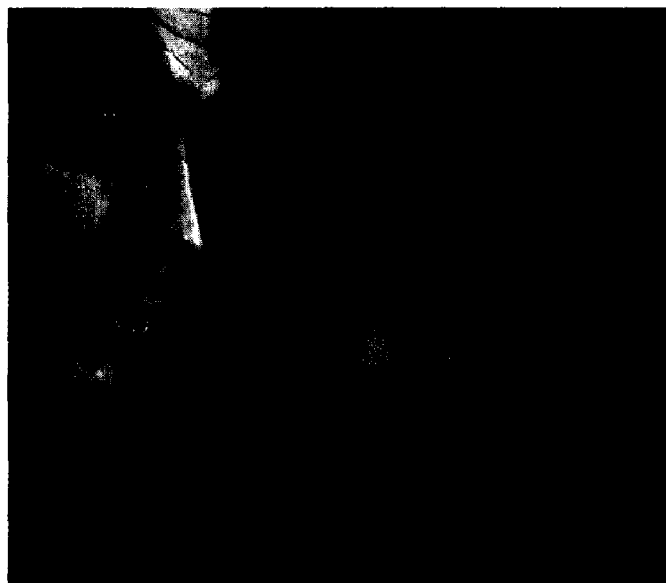


Spain's new transition

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The going will get tougher for the government

After his surprise election victory in March 2004, Spain's Socialist prime minister, José Luis Rodríguez Zapatero, quickly set about introducing a sharp and popular change of direction. In foreign policy, he organised a quick exit from the war in Iraq (while strongly affirming Spain's determination to fight terrorism), cosied back up to France and Germany and, as a "good European", helped to unblock the European Union's new constitution. At home he promised to work towards equality between the sexes, starting with the appointment of the same number of men and women to his cabinet. New laws addressed punishing domestic violence against women and allowing homosexuals to marry and adopt children. Mr Zapatero also scrapped



Zapatero speaks European

an extravagant river-diversion plan, increased the minimum wage and urged employers and unions to work together to create jobs. His popularity soared.

But in 2005 the going will get tougher for Mr Zapatero. From its economy to its politics, Spain faces a period of transition, for which it is not yet fully prepared. And it could be a bumpy ride.

First, there is the challenge of moving upmarket. For years Spain was able to attract huge flows of foreign investment thanks to its excellent mix of low labour costs and decent productivity. Not any more. That investment is flooding instead to central and eastern Europe and Asia, while Spain is starting to experience an exodus of its manufacturing and services through outsourcing and offshoring. In future the country must compete through the quality of its human capital, its innovation and its research and development. Spain also used to be the preferred destination of European tourists looking for sun and cheap hotels, booze and tobacco; now it needs to upgrade its infrastructure to cater for richer, fussier folk.

Second, Spain's Euro-bonanza is over. Spain was ▶

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▶ able to grow faster than the European average mainly because it benefited from large capital inflows in the 1980s through joining the EU, and from a large drop in interest rates in the 1990s through joining the euro. Moreover, it has received more than €100 billion (\$125 billion) in EU transfers since its accession in 1986. The Union's new enlargement to the east will present a market opportunity but also a competitive threat: the much poorer new members offer high-skilled and low-cost labour, and they will draw aid money that previously went to Spain, which will become a net contributor to the eu's coffers. So Spain will have to learn to compete on its own, without help from Brussels.

Then there is the matter of immigration. Spain, until recently a net exporter of people, has become a large net importer. Spaniards are living longer and having fewer babies (the birth rate is among the lowest in Europe), and the population is ageing fast. The nation needs to find a reasonable way to accommodate and assimilate hundreds of thousands of immigrants arriving every year from Africa, Latin America and eastern Europe (now 5% of the total population)—particularly demanding for a country that is not used to immigrants and where employment levels are still low.

In domestic politics, the perennial challenge of balancing central and regional government is, if anything, becoming harder. How to accommodate the increasingly strong demands of Basque and Catalan nationalists for more self-government without creating new privileges for them at the cost of the rest of the regions? Not least, Mr Zapatero faces the problem of adapting his generous election pledges (made in a bid to win against all the odds) to the new reality of power. The promised resources for social services, education, housing, health, infrastructure and R&D—among other things—may not be compatible with the government's target of a zero budget deficit.

Still, the economy will grow at a slightly faster pace in 2005 (despite the country's vulnerability to higher oil prices), as demand for Spanish goods picks up elsewhere in Europe. If Mr Zapatero spends his political capital wisely, he can rise to the challenge of Spain's new transition. But his honeymoon may soon be over. □