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Foreign Policy

Spain, the UK and Gibraltar Reach Historic Deal

Spain, the UK and Gibraltar, the British overseas territory claimed by Spain for almost 300 years, agreed a series of measures which will ease border crossings and improve transport and telecommunication links.

It was the first deal under the tripartite forum established in 2004 to air longstanding grievances which until then had been dealt with through megaphone diplomacy. Spain, however, has not dropped its sovereignty claim, but is not pursuing it aggressively. The key agreement is joint use of the Rock's airport by Spain and Gibraltar, with the building of a terminal that will straddle the border zone. The first flights to and from Gibraltar are expected by the end of the year. Up until now, Spain has only allowed flights to Gibraltar from Britain. When weather conditions were really bad, flights from the UK either had to land in Tangiers, Morocco, or in Spain and then passengers were bussed into Gibraltar.

Map 1. Gibraltar



Source: *The Economist*.

The UK also agreed to top up the pensions of some 6,000 Spaniards who worked in Gibraltar's Royal Navy dockyards and lost their jobs when General Franco closed the border in 1969. It was not fully opened until 1985.

Other measures include softening border controls to reduce queuing time and also boosting the number of phone lines into Gibraltar. Mobile roaming in Spain for Gibraltar mobile phones will also be allowed. Overall, the agreements will be good for business in Gibraltar and with Spain.

The Spanish flag will also fly on the Rock for the first time since 1954 when Franco closed the Spanish consulate in a fit of rage over a visit by the Queen. It will fly at a branch of the Cervantes Institute, Spain's institution for the learning of Spanish and the promotion of culture, which will be built.

The deal is one of the Socialists' few foreign policy successes and shows that its switch to a pragmatic charm offensive has paid dividends. However, the chances of the Rock being restored to Spain are pretty slim: in 2002 99% of Gibraltarians voted against shared sovereignty and in favour of remaining British.

The accord should have a substantially beneficial business impact and, perhaps as a result of it, Spain will win more friends and influence on the Rock.

Shortly before the deal, Spain failed to undermine British sovereignty over Gibraltar when it failed to persuade EU judges to prevent the Rock voting as part of a British Euro-constituency. The European Court of Justice ruled that there was no reason under EU law why Gibraltar should not be part of the South West constituency of the European Parliament. To Madrid's credit, it did not let this setback hinder progress on the other fronts.

Creation of New Post of Secretary of State for Latin America

The government reinforced its relations with Latin America by creating a new post in the Foreign Ministry and appointing Trinidad Jiménez, until then the Socialists' candidate for Mayor of Madrid in the next municipal elections, as Secretary of State for the region.

Her appointment gives the post a political weight as she is a member of the Socialists' Executive Committee in charge of international relations.

The Ministry now has, for the first time, four Secretaries of State. The creation of the new post takes some of the enormous work load off the shoulders of Bernardino León, the number two in the Ministry. Spain's large direct investment in Latin America, and, in particular, the problems surrounding Repsol YPF's investment in the recently nationalised Bolivian energy sector, coupled with the proximity of the post-Castro period, are among the elements that make the region increasingly important.

Miguel Ángel Moratinos, the Foreign Minister, signed at the end of September a new agreement with the United Nations Conference on Trade and Development (UNCTAD) which will enlarge the scope of Spain's technical cooperation activities in Latin America.

Domestic Scene

Government Gets Tough on Illegal Immigrants

The flood of immigrants into the Canary Islands from Africa during the summer, increasing public concern over the influx and criticism by some EU governments of Spain's policies has forced the government to crack down. Around 1,000 of the more than 25,000 immigrants who have arrived in the Canaries so far this year in fishing boats (over five times more than the total for 2005) were deported to Senegal (see *Inside Spain*, Newsletter 27, 6 September 2000).

'Our policy has to be very rigorous, and every immigrant must know –as must the mafia that traffics them– that anyone who arrives illegally will have to leave,' said Jesús Caldera, the Labour Minister. According to experts, there are now between 700,000 and 800,000 illegal immigrants living in Spain.

Immigration is becoming one of Spain's hottest political issues. Against a backdrop of dramatic pictures in the media of the bodies of immigrants washed up on Spain's beaches, a recent poll showed that 38% of Spaniards saw immigration as the country's biggest problem. María Teresa Fernández de la Vega, the Deputy Prime Minister, proposed a 'big national pact' on immigration with the centre-right Popular Party (PP), but the PP first wants the Socialists to accept that last year's regularisation, which benefited close to 600,000 illegal immigrants, was an error and that there will be no more. Regularisations by both the Socialists and the PP have benefited 1.2 million immigrants in Spain since 1986 (see Figure 1), the third-largest number in Europe and the United States (see Figure 2).

Figure 1. Regularisations of Illegal Immigrants, 1986-2005

| Year | Number Regularised | Party in Power |
|---------|--------------------|----------------|
| 1986 | 38,181 | Socialists |
| 1991-92 | 109,135 | Socialists |
| 1996 | 21,283 | Popular Party |
| 2000 | 169,157 | Popular Party |
| 2001 | 20,352 | Popular Party |
| 2001 | 36,013 | Popular Party |
| 2001 | 232,679 | Popular Party |
| 2005 | 577,923 | Socialists |
| Total | 1,204,723 | |

Source: *El País*.

Figure 2. Regularisations of Illegal Immigrants in Europe and the United States, 1986-2005

| Country | Number |
|--------------|------------------|
| US | 3,489,900 |
| Italy | 1,419,600 |
| Spain | 1,204,723 |
| Greece | 722,000 |
| Portugal | 243,200 |
| France | 198,900 |
| Belgium | 52,000 |
| Germany | 30,856 |
| Switzerland | 15,200 |
| Total | 7,376,379 |

Source: *El País*.

Although it is often argued that Spain's last regularisation encouraged other immigrants to head for Spain, experts are divided as to whether this is really the case. The government took this step because it wanted to take immigrants out of the black economy and give them basic rights, while benefiting the tax and social security systems. Some European leaders have criticised Spain for not consulting them beforehand, because illegal immigration is a Europe-wide problem (there are thought to be 5-8 million illegal immigrants across the EU). French Interior Minister and presidential hopeful Nicolas Sarkozy in particular has chastised Spain and Italy for encouraging clandestine migrants with their 'massive regularisations'. 'We cannot allow the massive regularisation of immigrants without consultations among countries' who have signed up to the EU's Schengen Treaty allowing passport-free travel. José Luis Rodríguez Zapatero, the Prime Minister, responded to this by saying that France, after the riots last year by immigrants, was in no position to tell Spain what to do.

The government was also criticised at a meeting of EU Justice and Interior Ministers in Finland where its call for more funds from Brussels to combat the problem was not received very sympathetically. Gunther Bechstein, Bavaria's Interior Minister, said Spain 'would not go under because 20,000 or 30,000 people had arrived in the Canary Islands'.

The European Commission wants more decisions on immigration to taken at the EU – rather than the national– level.

Spain's decade-long period of strong economic growth has created plenty of opportunities for immigrants, particularly in the booming construction and tourism sectors, the economy's bedrocks, and in agriculture and domestic help. A recent study pointed out that Spain's per capita GDP might have fallen by 0.6% a year over the past 10 years instead of growing by an annual average of 2.6%, thanks to the arrival of more than 3 million immigrants.

The country's 4.8 million international migrants, legal and illegal, account for 11% of Spain's population, according to the latest estimate by the UN Population Division (see Figure 3). The government and labour market experts are at odds over how many more immigrants the economy can absorb. While José Blanco, the Socialists' Secretary of Organisation, says the labour market cannot absorb any more, Marcos Peña, head of the Economic and Social Council (CES), says 'we have no capacity to know what is our capacity to absorb more immigrants'.

Figure 3. The Ten Countries with the Highest Number of International Migrants (millions)

| 2005 | Millions | % of the Country's Population | % of the Total |
|-----------------------|------------|-------------------------------|----------------|
| 1. US | 38.4 | 12.8 | 20.2 |
| 2. Russian Federation | 12.1 | 8.4 | 6.4 |
| 3. Germany | 10.1 | 12.2 | 5.3 |
| 4. Ukraine | 6.8 | 14.6 | 3.6 |
| 5. France | 6.5 | 10.7 | 3.4 |
| 6. Saudi Arabia | 6.4 | 26.1 | 3.3 |
| 7. Canada | 6.1 | 18.9 | 3.2 |
| 8. India | 5.7 | 0.5 | 3.0 |
| 9. UK | 5.4 | 9.0 | 2.8 |
| 10. Spain | 4.8 | 11.1 | 2.5 |

Source: Population Division of the United Nations Secretariat, *Trends in Total Migrant Stock: The 2005 Revision*.

Zapatero to Push Ahead with Basque Peace Process Despite Threats by Eta to Continue its Armed Struggle

José Luis Rodríguez Zapatero, the Prime Minister, said he still intended to start peace talks with Eta even though the Basque separatist group said it would not relinquish its weapons until the region gained independence and street violence has flared up again. Eta declared a permanent ceasefire in March and has not killed anyone for three years.

Three hooded gunmen told a rally of Eta sympathisers that their fight was not a thing of the past. This was the clearest sign yet that Eta could renew its violent struggle, which has produced more than 800 deaths in 40 years, if it does not get what it wants from the talks. The government, however, has little to offer Eta other than legalising Batasuna, its political party, if it respects the constitution, and perhaps the release of prisoners who do not have blood on their hands.

Mariano Rajoy, the leader of the PP, said Eta's statement showed there was no point negotiating. 'Eta has not changed', he said. 'It is still a terrorist organisation'.

Zapatero, however, gained support from Tony Blair, the UK Prime Minister, during his visit to Madrid. Blair, who achieved a peace deal in Northern Ireland with the IRA, urged Zapatero to press on with 'very patient determination'. 'It is always worth trying', he said. 'It is sometimes very difficult, but the correct thing is to do it'.

Government Agrees New Financing Deal for Catholic Church

Taxpayers, as of 2007, will be able to voluntarily donate to the Church more of their yearly tax declarations, but the government will no longer make an annual contribution to cover the shortfall between the Church's income and expenditure. The percentage contribution will rise from 0.52% to 0.7%.

The Church will also have to pay VAT on any sale or purchase of goods and property, as required by the European Union, and present a yearly report to the government on how it spends money received from taxpayers.

The accord is an historic one because it is a step towards the self-financing commitment established in the 1979 economic agreements between Spain and the Vatican. It remains to be seen, however, whether the Church will be able to manage on what it receives from taxpayers and whether it will pressure the government in the future for more money. The Church wanted a percentage contribution of 0.82%.

The Church was immensely powerful during the 1939-75 regime of General Franco –it took his side during the civil war– and has fiercely resisted renouncing the privileges it was accorded. Under the 1978 constitution, the Church formally separated from the state, but the governments of the day continued to finance it even though Spain is a predominantly lay society and other faiths have flourished, particularly Islam with the influx of immigrants. The Church receives more than €5 billion a year from the state, of which only €150 million came from taxpayers in 2005. The main items are the state's subsidies for private Catholic schools (more than €3 billion a year) and paying the salaries of teachers of religion. Taxpayers cannot make contributions to other faiths via their tax declarations: these receive between them around €3 million a year from the state and increasingly complain of discrimination.

The government has clashed with the Church since taking office in April 2004, principally over introducing legislation facilitating divorce on demand and gay marriages. It also scrapped plans to make religion an obligatory subject in schools.

Global Warming Threatens Spain's Beaches

Spain's beaches could shrink by an average of 15 metres by 2050 because of global warming, according to a report by the Environment Ministry. A rising sea also threatens to flood beach-side homes.

Professor Raúl Medina, the report's coordinator, told the newspaper *El País* that he would not buy a house in La Manga because 'I doubt that my children would be able to use it'. La Manga (Murcia) on the Mediterranean coast is one of many resorts which thrive on tourism and rampant construction. Many resorts are already bringing in sand each spring.

The warning came as the government prepared to protect the country's overdeveloped coastline by forcing owners to sell land to the state at market prices. A fighting fund of €60 million has been created to buy 8,000 hectares of land. One of the first areas targeted is a campsite above a virgin beach in the northern region of Asturias, an area that has so far escaped the ravages of the Mediterranean coast.

Spain's sweltering summer lasted well into the first half of September: 20 cities posted record monthly temperatures in the first week of the month.

Spain Continues to Lag in Education

Spain's public spending on education is almost the lowest among OECD countries (28th out of 30), 30% of students leave secondary without having passed their exams (OECD average of 12%) and only 61% of those under the age of 25 have either completed their secondary education or a vocational course compared to an EU average of 81%.

Public spending dropped from 4.6% of GDP in 1995 to 4.3% in 2003 (see Figure 4).

Figure 4. Public Spending on Education by Selected Countries (% of GDP) (1)

| Country | 1995 | 2003 |
|--------------|------------|------------|
| France | N/A | 5.9 |
| Germany | 4.6 | 4.7 |
| Hungary | 5.3 | 5.9 |
| Italy | 4.9 | 4.9 |
| Japan | 3.6 | 3.7 |
| Spain | 4.6 | 4.3 |
| Turkey | 2.4 | 3.7 |
| UK | 5.2 | 5.4 |
| OECD average | 5.3 | 5.5 |

(1) All levels.

Source: OECD.

The latest figures in the OECD's annual *Education at a Glance* are for 2003 when the centre-right Popular Party (PP) was in power. As usual, the figures have provoked mutual recriminations between the Socialists and the PP. The PP blames the situation on Socialist education reforms put into place between 1983 and 1996 and the Socialists blame the PP, which ruled from 1996 to 2004, for reducing public expenditure on education. Whatever the truth of the matter, everyone agrees that Spain's education system is in crisis.

The Economy

Spain 'Broke EU Law' in E.on's Take-over Bid for Endesa

The European Commission ruled that Spain broke EU law by imposing restrictions on the proposed take-over of power firm Endesa by Germany's E.on. The long-running saga over Endesa was further heightened by Acciona, a Spanish engineering and building group, acquiring 10% of Endesa and so joining the battle.

The Commission's verdict against Spain was widely expected (see *Inside Spain*, Newsletter 27, 6 September 2006). It focused on two main breaches of EU law: the government usurped Brussels' powers to impose conditions on mergers and the conditions imposed on E.on by Spain's power regulator, the National Energy Commission, whose remit was expanded, broke EU rules on the free movement of capital.

The tough stance by the Commission was seen as an attempt to turn the tide over protectionism by some European governments. Madrid had originally favoured a lower bid for Endesa by the Barcelona-based Gas Natural in order to create a national champion in the energy sector. The Commission said its decision was 'legally binding and could be invoked before a national court or public authority in Spain'.

The conditions for authorising the take-over would have forced Endesa to sell off a nuclear power station and other energy generating assets.

The emergence of Acciona as a major player in the Endesa saga took the markets by surprise. It paid €32 a share for its 10% stake in Endesa, well above the €24.5 offered by E.on and the €21.3 by Gas Natural. E.on very quickly came back with a new offer of €35 a share. Acciona said it could raise its stake to almost 25%.

Acciona's move raised suspicions, denied by all parties, that it was doing the government's bidding and perhaps increasing the chances of Endesa remaining in Spanish hands. If nothing else it has thrown a spanner into the works.

In a further twist in Spain's energy sector, Acciona's rival, ACS, which owns 35% of Unión Fenosa, the country's third-largest electricity generator, acquired 10% of Iberdrola, the number two generator, in what could lead to a merger of the two. If that happened the government would have its national champion, though not the one it wanted.

Meanwhile, the saga is good business for stock market investors. The Madrid index reached an all-time high of 12,934 at the end of September, a gain of 20.5% this year.

Santander Buys US Vehicle Financing Company

Grupo Santander, Spain's largest banking group, is to pay US\$651 million for 90% of Drive Financial, a Texas-based vehicle financing company. This is the group's second big investment in the United States in less than a year, following its purchase of 25% of Sovereign, a savings bank, for US\$2.9 billion. Santander is already a major player in the European consumer finance market.

Drive Financial operates in 35 states and is considered one of the leading lenders in the so-called 'sub-prime' segment.

Algeria Tightens its Energy Sector, Affecting Spanish Companies

Spain's three leading oil and gas companies –Repsol YPF, Gas Natural and Cepsa– are expected to be directly affected by stricter operating and tax laws for foreign oil companies operating in Algeria. The three have significant interests in the country which is Spain's main supplier of gas.

Under the new laws, effective as of 1 August, Algeria's state-run oil company Sonatrach must hold a minimum 51% stake in all petroleum-oriented contracts from a previous obligatory 20%-30% participation.

Algeria has also imposed new tax requirements, charging a rate of between 5%-50% for the 'extraordinary earnings' generated by crude oil when the price of Brent crude exceeds US\$30 per barrel.

Spain's Energy Dependence Reaches a Record 85%

Spain is becoming increasingly dependent on imported energy. Last year its energy dependence –imports as a proportion of domestic consumption– reached an all-time high of 85%, up from 77% in 2004 (see Figure 5).

Figure 5. Energy Dependence of Selected EU Countries (%)

| Country | 2005 |
|----------------|-------------|
| Italy | 105.5 |
| Portugal | 99.4 |
| Spain | 85.1 |
| Germany | 65.1 |
| EU-25 average | 55.9 |
| France | 54.5 |
| UK | 13 |

Source: Eurostat.

The dependence rose sharply in 2005 because of higher consumption and falling domestic production, particularly nuclear energy. Alternative sources, such as wind-power, are playing a greater but not yet very significant role.

Spain Stands Still in Global Competitiveness Index

Spain remained in 28th place out of 125 countries in the World Economic Forum's (WEF) latest Global Competitiveness Index (see Figure 6).

Figure 6. Global Competitiveness Index, 2006 and 2005 Comparisons

| Country | GCI 2006 Rank | GCI 2006 Score | GCI 2005 Rank | Changes 2005-2006 | |
|-------------------|------------------|-------------------|------------------|-------------------|----------|
| Switzerland | 1 | 5.81 | 4 | ↗ | 3 |
| Finland | 2 | 5.76 | 2 | → | 0 |
| Sweden | 3 | 5.74 | 7 | ↗ | 4 |
| Denmark | 4 | 5.70 | 3 | ↘ | -1 |
| Singapore | 5 | 5.63 | 5 | → | 0 |
| US | 6 | 5.61 | 1 | ↘ | -5 |
| Japan | 7 | 5.60 | 10 | ↗ | 3 |
| Germany | 8 | 5.58 | 6 | ↘ | -2 |
| Netherlands | 9 | 5.56 | 11 | ↗ | 2 |
| UK | 10 | 5.54 | 9 | ↘ | -1 |
| Hong Kong SAR | 11 | 5.46 | 14 | ↗ | 3 |
| Norway | 12 | 5.42 | 17 | ↗ | 5 |
| Taiwan | 13 | 5.41 | 8 | ↘ | -5 |
| Iceland | 14 | 5.40 | 16 | ↗ | 2 |
| Israel | 15 | 5.38 | 23 | ↗ | 8 |
| Canada | 16 | 5.37 | 13 | ↘ | -3 |
| Austria | 17 | 5.32 | 15 | ↘ | -2 |
| France | 18 | 5.31 | 12 | ↘ | -6 |
| Australia | 19 | 5.29 | 18 | ↘ | -1 |
| Belgium | 20 | 5.27 | 20 | → | 0 |
| Ireland | 21 | 5.21 | 21 | → | 0 |
| Luxembourg | 22 | 5.16 | 24 | ↗ | 2 |
| New Zealand | 23 | 5.15 | 22 | ↘ | -1 |
| Republic of Korea | 24 | 5.13 | 19 | ↘ | -5 |
| Estonia | 25 | 5.12 | 26 | ↗ | 1 |
| Malaysia | 26 | 5.11 | 25 | ↘ | -1 |
| Chile | 27 | 4.85 | 27 | → | 0 |
| Spain | 28 | 4.77 | 28 | → | 0 |

The WEF said Spain's strengths are reflected in excellent school enrolment rates at all levels of the educational ladder, very strong public health indicators, good infrastructure and a stable macroeconomic environment. It said its 'most gaping weakness' is the lack of flexibility and efficiency of its labour markets as well as existing distortions in its goods markets. More also could be done to reduce the burden of bureaucracy and red tape and to boost the quality of institutions of higher education, including those engaged in scientific research and technology innovation.

Spain is standing still, but the government can draw comfort from the demise of Italy, which dropped from the 38th to the 42nd slot.