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Spain's Bid to Lead EU Rapprochement with Cuba Upsets Island's Dissidents

Santander to Purchase UK's Abbey National

Spain wants to lead the European Union in changing its policy of isolating the Cuban government. The new policy, mooted for several months (see *Inside Spain*, Newsletter 5, September 8, 2004), was signalled by Carlos Alonso Zaldívar, Spain's ambassador to Cuba, who said the current situation was 'profoundly unsatisfactory' and that the sanctions were of 'doubtful practical utility'.

The EU unanimously agreed to reduce high-level governmental visits and participation in cultural events in Cuba after the summary execution by firing squad in 2003 of three people who hijacked a ferry in an attempt to escape the country and the crackdown on dissidents. Countries also decided to invite dissidents to national holiday celebrations at their embassies in Havana as a sign of support for the island's internal opposition.

The sanctions imposed in 2003 pushed back EU-Cuba relations to the low level of 1996 when the EU, during Spain's presidency under the previous centre-right Popular Party (PP) government of José Maria Aznar, voted a Common Position conditioning a full European cooperation package to reforms to be taken by the Cuban regime.

The announcement was made on Spain's national day and did not please many of the dissidents who attended the celebrations in the ambassador's residency in Havana. Several of them walked out afterwards. The invitations to dissidents went out after those to other Cubans, suggesting that Spain's Foreign Ministry was rethinking whether to invite them.

Three days after the announcement Jorge Moragas, the PP's senior official for foreign policy, embarrassed the Socialist government and triggered a diplomatic spat between the two countries by being denied entry to Cuba to see dissidents. He went to the island on a tourist visa which meant he could not conduct political activities. He was held and put on the first flight back to Madrid.

Spanish Foreign Minister Miguel Ángel Moratinos said Moragas had received 'unacceptable treatment' and urgently summoned Cuba's ambassador in Madrid. But he

also seemed to chide the PP, saying Spanish policy towards Cuba was up to the government, not ‘a domestic policy issue’ open for debate among parties.

As a result of the sanctions, EU ambassadors in Cuba have no contact at all with any parts of the government and also with other sectors of society, such as academics, who for one reason or another prefer to keep their distance. The ambassadors are known as ‘Findus ambassadors’ after the frozen food. This makes their professional life in Cuba highly unproductive.

Spain believes the time has come to seek a more constructive *modus vivendi* with Cuba where the Castro regime is entering its twilight years amidst tighter economic conditions, partly due to the tougher US embargo. Castro is 78 and recently fell over and broke a knee and arm.

But Spain is caught between a rock and a hard place. On the one hand, many dissidents fear being abandoned by Spain (for historic reasons and even during the 1939-75 Franco regime the European country with the closest ties to the island) and, on the other, the EU-25 does not have a common position on any new direction in which it might move. The eight new former communist EU nations are particularly adamant about continuing the tough line. The UK, however, broadly supports Spain’s position and believes the time has come to move on from the current impasse. Spain cannot afford to break ranks with the EU and pursue a unilateral policy.

Socialists Launch Charm Offensive to Win Over Gibraltar

In a significant change of policy, the government has decided to woo Gibraltar rather than antagonise it by actively pursuing its centuries-old sovereignty claim. Miguel Ángel Moratinos, Spain’s Foreign Minister, and his UK counterpart, Jack Straw, agreed to re-launch the stalled talks in a new co-operative spirit and give Gibraltar, for the first time, a seat at the negotiating table (a formula known as ‘two flags, three voices’).

Points to be discussed in the new forum include an agreement for joint use of Gibraltar airport, to allow planes flying to Gibraltar to divert to Spanish airports if necessary and to resolve the problem of pensions for Spaniards who had worked on the Rock. Spain also agreed to allow cruise liners visiting Gibraltar to dock at any Spanish port, settling a row that soured relations earlier this year (see *Inside Spain*, Newsletter 5, September 8, 2004).

The new policy echoes the one that Fernando Morán, Spain’s Socialist Foreign Minister, unsuccessfully tried to implement in 1984. Many analysts have long said that until Spain wins the confidence of Gibraltarians it has a zero chance of ever flying the Spanish flag over the Rock. Gibraltarians have the last word on any deal as it would still have to be put to a referendum. ‘We will always honour the wishes of the people of Gibraltar as to their future, so unless they are fully able to participate, there’s frankly little point in having the discussions’, Straw said.

Gibraltarians overwhelmingly rejected an Anglo-Spanish proposal for joint sovereignty, negotiated by the previous government, in November 2002.

‘We need Gibraltar involved: that’s the only way forward’, said Moratinos. ‘We have made an important step in the long process to reconcile Spain’s wish to recover sovereignty and the interests of the Gibraltarians’.

The Strains in Spain’s Relations with the US Exposed on Columbus Day

George L. Argyros, the US ambassador to Spain, boycotted the annual parade that celebrates Spain’s national holiday and Christopher Columbus’s first sighting of land in the Americas, because at last year’s parade the then leader of the Socialist opposition party, José Luis Rodríguez Zapatero, now the prime minister, did not stand up when the American flag passed by.

Zapatero stood up for the troops of other nations, but not for US soldiers. He had made his position on withdrawing Spanish troops from Iraq, if he won the March 2004 general election, very clear months before the parade, and so his decision not to stand up was hardly surprising. Nevertheless it irritated Washington.

The Spanish government is hoping, *sotto voce*, that John Kerry will be the next US president. Opinion polls show that Spain is one of the European countries most opposed to a second term in office by George W Bush, just as it was the nation most against the war with Iraq.

Spain wins Algeria’s Support for its Efforts to Achieve Western Sahara Solution

Spain and Algeria have cleared up a misunderstanding over their respective positions on the Western Saharan conflict and reiterated their joint support for the Baker plan for self-determination. The move came shortly before the UN Security Council extended the mandate of the United Nations Mission for the Referendum in the Western Sahara (MINURSO) until 30 April 2005.

Spain is intensifying its efforts to find a solution to the 30-year old conflict over the Western Sahara, sparked in 1975 when the last government of General Franco abandoned the territory on the west coast of North Africa under its sovereignty and Morocco annexed it, moving in settlers (see *Inside Spain*, Newsletter 5, September 8, 2004). The conflict is one of the longest and most neglected disputes in the post-colonial era.

Fighting ended in 1991 with a UN-negotiated ceasefire that called for immediate self-government and a referendum within five years on whether the territory would become independent or part of Morocco.

Morocco, however, maintains its claim to sovereignty over the territory and has instead offered the region autonomy. The Polisario Front continues to press for a referendum and recently threatened to take up arms again. It also received a boost in September when South Africa recognised the Saharan Arab Democratic Republic, emboldening the Polisario’s cause and giving it more international respectability. President Thabo Mbeki sent a message to king Mohammed VI of Morocco, comparing the Saharans to the Palestinians.

Algeria's Foreign Minister Abdelaziz Belkhadem said his government now shared the same position as Spain. 'The two countries abide by international legality, the Baker plan and the right of the Sahrawi people to self-determination', he said. Around 160,000 Sahrawi refugees and their children still live in camps in Algeria.

In August, Algerian President Abdelaziz Bouteflika rejected a Spanish proposal for direct talks between Algeria and Morocco and insisted his nation would not play an active role in resolving the conflict. The reason for this, said Belkhadem, was that 'at the beginning there were no references to the Baker Plan. We thought Spain was thinking of a different solution. Now, they have confirmed that they support the Baker plan'.

Despite Spain's best efforts, the situation is tense and according to UN Secretary General Kofi Annan more complicated to resolve than ever. There have been unconfirmed reports of troop movements on the border between Morocco and Algeria (closed since 1994).

Algeria is an increasingly important source of natural gas for Spain and along with Morocco the source of most of the terrorists responsible for the March 11 bombings in Madrid.

Spain Rejects EU Transit Camp for Refugees

Spain and France rejected German-Italian plans to set up a European Union transit camp in North Africa for refugees from Africa, the Middle East and Asia and called on the UN High Commission for Refugees to take responsibility rather than the EU.

The idea, first raised in 2003 by Britain, was studied at a summit in Florence of interior ministers from the five big EU countries. The camp would be used to process asylum-seekers before they reached the border of the EU. It is hoped that this would combat illegal trafficking that has seen thousands drown in the Mediterranean.

Santander to Purchase UK's Abbey National

Banco Santander is to acquire Abbey National, the UK's sixth largest bank, for €13.4 billion, following approval of the deal by the shareholders of both banks. It will be the biggest cross-border bank merger in Europe (see *Inside Spain*, Newsletter 5, September 8, 2004).

The acquisition will make Grupo Santander one of the world's largest banking groups. In terms of market capitalisation it will be the 10th largest in the world and the biggest in the euro zone (around €50,000 million). On the basis of 2003 figures, it would have €617.9 billion of assets (83% of Spain's 2003 GDP), loans of €335.6 billion and deposits of €244.7 billion. Abbey's incorporation would increase Grupo Santander's business (loans + deposits) by 90%. Abbey is the UK's second largest bank in mortgages.

The integration of the two banks will create a front-line international franchise with a strong presence in Europe, particularly Spain, the United Kingdom and Portugal, and Latin America. The geographic diversification among emerging, mature and stable economies is one of the big values of the resulting entity. More than 90% of the loan portfolio would be in countries with a risk classification of AA or higher (Euro zone and

United Kingdom). Another of its strengths lies in the concentration on retail banking, which will represent around 85% of revenues, higher than that of most of the world's large banking groups.

Abbey represents a unique opportunity for entering the UK retail banking market, one of the most attractive and profitable in Europe. It has a large retail banking platform, an extensive network of branches (740), 17.8 million customers (almost one in every three residents of the UK) and an 11% share of the UK mortgage market.

Santander says the acquisition of Abbey would generate additional earnings as of 2007 of €670 million a year, €450 million of which would come from costs and savings and €220 million from higher revenues. It would achieve this by:

- Focusing on the core banking business.
- Establishing its strong culture of customer service.
- Boosting the branch network's distribution capacity through cross-selling (consumer finance, insurance for mortgage customers).
- Streamlining the range of products and the products themselves.
- Improving the levels of efficiency, mainly via technology.

It is estimated that €680 million of investment over three years will be needed to achieve these extra earnings, to which has to be added costs associated with reducing the number of Abbey employees by 3,000 (€90 million, approximately).

Emilio Botín, Santander's chairman, quickly put his stamp on Abbey by appointing Francisco Gómez Roldán, his chief financial officer, as Abbey's new CEO rather than keeping the current CEO.

Government Reaches Tentative Agreement with Unions over Ailing Shipyards

The government and shipyard workers seem to have settled some of their differences and agreed to split the Izar group into military and civil wings as part of a rescue plan (see *Inside Spain*, Newsletter 6, October 4, 2004).

Under the plan of the state industrial holding company, SEPI, one business would comprise Izar's shipyards in Ferrol, Cadiz, Puerto Real and Cartagena –all military shipyards– while the other would comprise Izar's civil shipyards. SEPI will continue to have full control of the military shipyards and 49% of the civil ones. Spain's savings banks, which have a special status and are to a large extent politically controlled, have been approached with a view to acquiring part of the civil shipyards.

The military shipyards, in a change from the original plan, will be able to allocate 20% of their production to civil projects for the next 10 years. This agreement, which was negotiated with Brussels, seeks to smooth out cyclical fluctuations in military orders.

The crisis in the shipyards was brought to a head by the previous centre-right government's illegal injection of more than €1.2 billion in illegal state aid. The European Commission has ordered the government to repay the aid.

Spain Stands Still in World Economic Forum Competitiveness Ranking

Spain remained in 23rd position out of 104 countries in the 2004 Growth Competitiveness Index of the World Economic Forum, just behind Chile but ahead of France and Italy (see Figure 1). The rankings are drawn from the results of a comprehensive survey among business leaders designed to capture a broad range of factors affecting an economy's business environment that are key determinants of sustained economic growth. Particular attention is placed on elements of the macroeconomic environment, the quality of public institutions and the level of technological readiness and innovation.

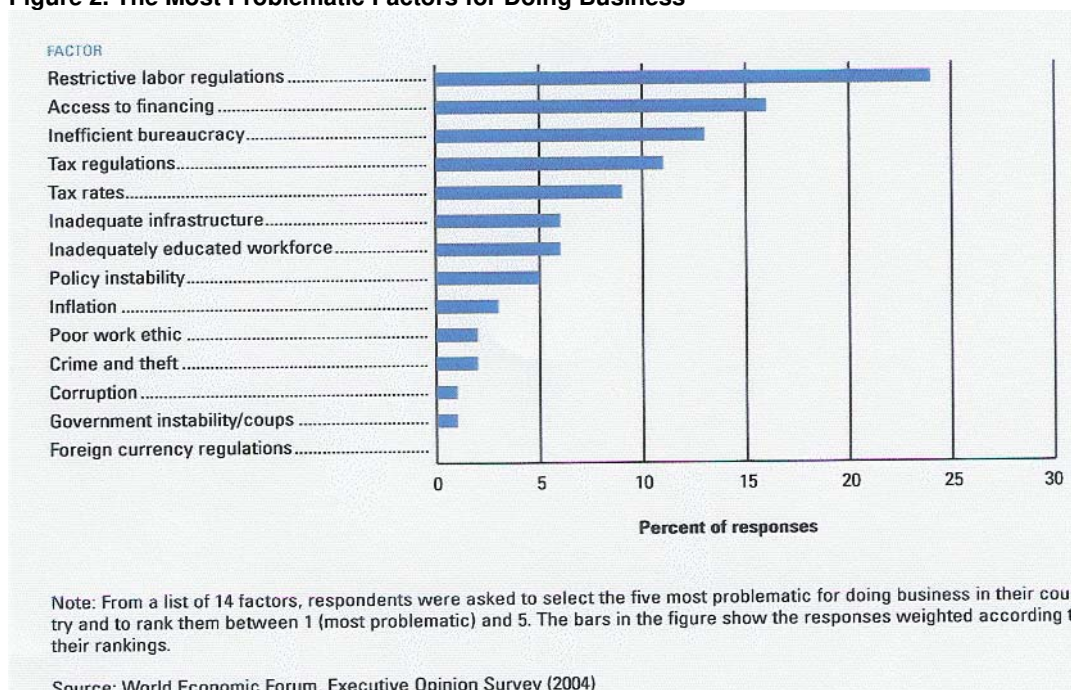
Figure 1. 2004 Growth Competitiveness Index rankings, selected countries

| Position and Country | Position in 2003 |
|----------------------|------------------|
| 1. Finland | 1 |
| 2. United States | 2 |
| 9. Japan | 11 |
| 11. United Kingdom | 15 |
| 13. Germany | 13 |
| 20. Estonia | 22 |
| 23. Spain | 23 |
| 24. Portugal | 25 |
| 27. France | 26 |
| 47. Italy | 41 |

Source: World Economic Forum.

The most notable improvements in Europe were the United Kingdom (up four places) and Estonia, by far the most competitive economy among the 10 countries that joined the EU in May. Spain's weakest points for doing business are restrictive labour regulations and access to financing (see Figure 2).

Figure 2. The Most Problematic Factors for Doing Business



Spain's Labour Costs Edge Closer to Canada's and Italy's

Spain's labour costs are approaching those of Canada and Italy, according to the latest annual survey by Germany's IWD (see Figure 3). Rising costs together with stagnant productivity in Spain is one of the reasons why some foreign companies have relocated to lower-cost countries (see *Inside Spain*, Newsletter 2, May 5, 2004).

Figure 3. Labour Costs of Selected Countries, 2003 (per hour worked in euros in the manufacturing sector)

| Country | Cost |
|----------------|--------------|
| Norway | 28.15 |
| West Germany | 27.09 |
| France | 20.15 |
| United States | 19.91 |
| United Kingdom | 18.72 |
| Canada | 16.83 |
| Italy | 16.69 |
| Spain | 15.97 |
| Portugal | 7.0 |
| Poland | 3.26 |

Source: IWD.

Spain, World's 11th Largest Exporter

Spain's exports in 2003 were the 11th largest in the world in absolute terms and 27.2% in GDP terms (see Figure 4).

Figure 4. Main Exporting Countries, 2003

| Country | Exports of Goods and Services (US\$ bn) | As a % of GDP |
|----------------|--|----------------------|
| United States | 1,006.5 | 9.2 |
| Germany | 860.1 | 35.8 |
| Japan | 542.1 | 12.5 |
| China | 482.9 | 34.2 |
| France | 482.7 | 27.6 |
| United Kingdom | 433.4 | 24.1 |
| Italy | 363.0 | 24.7 |
| Netherlands | 357.5 | 69.7 |
| Canada | 311.3 | 37.2 |
| Belgium | 296.3 | 98.0 |
| Spain | 228.3 | 27.3 |
| South Korea | 225.5 | 37.1 |

Source: IWD and IMF for GDP estimates in current US\$.

Spain Lags Way Behind in Patents

Spain's backwardness in the field of science and technology is underscored by the latest statistics regarding requests for patents. The number of requests made to the European Office of Patents increased from 609 in 1998 to 723 in 2001 (the latest year). This works out at 18 per one million inhabitants, almost the lowest figure among the EU-15 countries and well below the EU-25 average of 109 (see Figure 5).

Spain spends only 1% of GDP on R&D, a figure which the government wants to substantially increase (see *Inside Spain*, Newsletter 1, April 1, 2004). Spain is the only OECD country that spends more on lotteries (1.8% of GDP) than on R&D.

Figure 5. Requests for Patents per Million Inhabitants

| Country | 2001 | 1998 |
|----------------|-----------|-----------|
| Finland | 252 | 202 |
| France | 119 | 109 |
| Germany | 263 | 218 |
| Hungary | 10 | 7 |
| Ireland | 47 | 37 |
| Italy | 66 | 57 |
| Spain | 18 | 15 |
| United Kingdom | 93 | 78 |
| United States | 95 | 92 |
| EU-25 | 109 | 92 |

Source: Eurostat.

Spain's Total Tax Revenue Rises Slightly and Surpasses the UK's

Spain's total tax revenue inched up to 35.8% of GDP in 2003 from 35.6% in 2002. The tax burden is now for the first time a little bit higher than the United Kingdom's but still well below that of the other large EU countries (France, Germany and Italy, see Figure 6). The burden has almost doubled since 1975, the steepest rise after Turkey among OECD countries.

Figure 6. Total Tax Revenue (as a % of GDP)

| Country | 2003 (p) | 1975 |
|----------------|-------------|-------------|
| France | 44.2 | 35.9 |
| Germany | 36.2 | 35.3 |
| Italy | 43.4 | 26.1 |
| Spain | 35.8 | 18.8 |
| United Kingdom | 35.3 | 35.3 |
| United States | 25.4 | 25.6 |

Source: OECD Revenue Statistics.

Spain's Foreign Population reaches 7% of the Total Population

Spain's foreign population was 3.1 million at the end of July, 7% of the total of 43 million and proportionately more than double that of 2001, according to the National Statistics Office (INE). This segment of the population is now approaching the EU average, depending on how it is defined. INE's figure is based on registration with town halls, which gives residents the right to health assistance and schooling for children, and could be higher as not everyone registers (see Figure 7).

Figure 7. Spain's Population and Number of Foreigners, 1998-2004*

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004* |
|------------------|-------|-------|-------|-------|-------|-------|-------|
| Total (millions) | 39.85 | 40.20 | 40.49 | 41.11 | 41.83 | 42.71 | 43.0 |
| Foreigners | 0.637 | 0.748 | 0.923 | 1.37 | 1.97 | 2.66 | 3.14 |
| As % of total | 1.6 | 2.48 | 2.27 | 3.3 | 4.7 | 6.2 | 7.2 |

(*) July 31.

Source: INE.

The sharp and ongoing rise in the foreign population (from only 165,000 in 1976) is due to the huge inflow of immigrants (almost 500,000 in the first seven months of 2004). Spain received one in every three immigrants arriving in the EU during 2003. New immigrants are and have almost always been illegal immigrants as it is virtually impossible to emigrate legally to Spain if you are not an EU citizen.

The INE said it was too early yet to say whether the government's new proposed regulations on immigrants as of August were acting as a siren call (see *Inside Spain*, Newsletter 5, September 8, 2004). The government has agreed with employers and trade unions that all illegal immigrants who have been registered with their local town hall for

more than six months and who have had a pre-contract for a job for at least six months (three months in the case of agricultural workers) will have a right as of next year to residency permits.

The INE figure and that of the Interior Minister on the number of legal immigrants (1.7 million with residency permits) enable one to gauge the number of illegal immigrants. The difference between the two figures of 1.4 million theoretically corresponds to the number of illegal immigrants.

Despite the very sharp rise in Spain's population, after many years of stagnation, and the relative rigidity of its labour market, the country achieved the second largest reduction in its unemployment rate among EU-15 nations between 1995 and 2003 (see Figure 8).

Figure 8. Change in Unemployment Levels, 1995-2005

| Country | Unemployment Rate 2003 (%) | Change since 1995 in Percentage Points |
|--------------|-------------------------------|---|
| Austria | 4.4 | +0.5 |
| Belgium | 8.1 | -1.6 |
| Finland | 9.0 | -6.4 |
| France | 9.4 | -1.9 |
| Germany | 9.3 | +1.3 |
| Greece | 9.3 | +0.1 |
| Ireland | 4.6 | -7.7 |
| Italy | 8.7 | -2.8 |
| Luxembourg | 3.7 | +0.8 |
| Portugal | 6.4 | -0.9 |
| Spain | 11.3 | -7.5 |

Source: IWD.

OECD urges Spain to Improve its Environmental Policies

The OECD's latest report on Spain's environmental performance urges the government to improve the efficiency of policies, integrate environmental concerns in sectors such as tourism, construction, transport, energy and agriculture, and implement its international commitments.

In order to comply with the Kyoto protocol, Spain must limit the increase in its emissions between 2008 and 2012, ensuring that they do not exceed a level 15% higher than in 1990. Current emission levels are 40% higher than in that year. Targets were recently set to bring down emission levels in the future.

Over the past decade, Spain has significantly improved its environmental policies, and the report praises a number of achievements:

- Strengthened institutional and legislative environmental framework at national and regional levels, based on EU directives, a network of environmental authorities, and new laws.
- Greater emphasis on nature and biodiversity such as management of protected areas, Natura 2000 proposals, more international co-operation, and a national biodiversity strategy.
- Improved municipal water infrastructure and quality of coastal bathing waters.
- Recent revision of water management policies, in line with the EU water framework directive.

- Renewed commitments to climate change policies, in line with EU and Kyoto commitments.

But it needs to improve its environmental management by:

- Further controlling air emissions of sulphur oxide (SO_x), nitrogen oxide (NO_x), volatile organic compounds (VOCS), ammonia (NH₃) and improving air quality by reducing ground level ozone and particulates from stationary and transport sources.
- Shifting to water demand management and efficient water pricing.
- Phasing out environmental subsidies and making better use of economic instruments to encourage the efficient management of resources and reduce pollutants.
- Anticipating the EU reduction of environmental support in areas such as water infrastructure.
- More tightly enforcing pollution and land use regulations, such as coastal zone protection, at national and regional levels.

The OECD suggests that Spain could progress towards sustainable development by:

- Integrating environmental concerns into tourism, construction, transport, energy and agriculture policies by reviewing the environmentally harmful impact of the taxes and subsidies in these sectors and developing strategic environmental assessments for them.
- Reforming the ecotax.
- Decoupling waste generation and energy consumption from economic growth in relevant sectors.
- Following the international environmental agenda by curbing greenhouse gas (GHG) growth, further increasing official development assistance loans (ODA), ratifying the Aarhus convention, preventing marine pollution caused by land based pollution and oil spills, and better managing fisheries.

The European Pollutant Emission Register (EPER) also issued its first report which said that Spain has 11 of the 73 most contaminating industries in the former EU-15 countries. The report only covered 23% of Spain's potentially polluting facilities.

Spain Improves in Corruption League and is Ranked Equal with France

Spain moved from 23rd to 22nd position in the 2004 corruption perceptions index, the same position as France and well above Italy, and it was one of six countries that improved the most over the past decade (see Figure 9). Spain's score (out of 10) rose from 4.35 to 7.1. Most of improvement gradually took place during the previous centre-right government of the Popular Party.

Spain's continued weak points are the lack of sufficient transparency in the bidding process for contracts, the financing of political parties and the housing sector.

Figure 9. Transparency International Corruption Perceptions Index, 2004

| | Score (1) | Ranking out of 146 Countries |
|--------------------------------------|------------|------------------------------|
| EU-15 | | |
| Austria | 8.4 | 13= |
| Belgium | 7.5 | 17 |
| Denmark | 9.5 | 3 |
| Finland | 9.7 | 1 |
| France | 7.1 | 22 |
| Germany | 8.2 | 15 |
| Greece | 4.3 | 49= |
| Ireland | 7.5 | 17= |
| Italy | 4.8 | 42 |
| Luxembourg | 8.4 | 13= |
| Netherlands | 8.7 | 10 |
| Portugal | 6.3 | 27 |
| Spain | 7.1 | 22= |
| Sweden | 9.2 | 6 |
| United Kingdom | 8.6 | 11 |
| New EU members and candidates | | |
| Bulgaria | 4.1 | 54= |
| Croatia | 3.5 | 67= |
| Cyprus | 5.4 | 36 |
| Czech Republic | 4.2 | 49 |
| Estonia | 6.0 | 31 |
| Hungary | 4.8 | 42 |
| Lithuania | 4.6 | 44 |
| Latvia | 3.8 | 57 |
| Malta | 6.8 | 25 |
| Poland | 3.5 | 67= |
| Romania | 2.9 | 87 |
| Slovenia | 6.0 | 31= |
| Slovakia | 4.0 | 57= |
| Turkey | 3.2 | 77 |

(1) The CPI score relates to perceptions of the degree of corruption as seen by business people, academics and risk analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).

Source: Transparency International.