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Foreign Policy

Spain Calls for Gibraltar to be Blacklisted as a Tax Haven

The government urged the Organisation for Economic Cooperation and Development (OECD) to include Gibraltar, a British overseas territory which Spain has claimed for over two centuries, on its list of blacklisted tax havens because the Rock was failing to cooperate in investigating financial corruption and money-laundering activities.

The Spanish Treasury Department claimed Gibraltar had not been forthcoming in helping to clamp down on Spanish tax evaders and money launderers. Peter Caruana, Gibraltar's Chief Minister, denied the allegation.

The 6.5 square-kilometre territory has 28,000 registered companies and 28 firms of lawyers, according to information published in the Spanish press. It is an open secret that a lot of the construction boom on the adjacent Costa del Sol is linked to money-laundering. In one spectacular operation in 2005, known as Operation *Ballena Blanca* (White Whale), police arrested some 60 people suspected of laundering more than €600 million for gangs involved in murder, drug trafficking, arms dealing and prostitution. According to research by Jennifer Sands, a lecturer in European politics at Leeds University, England, there are myriad organised crime groups engaged in a whole range of illegal activities in Spain.

The Spanish authorities said Gibraltar had provided no help in this investigation, although it was one of 34 tax havens classified as 'co-operating' (the five uncooperative ones are Andorra, Liberia, Lichtenstein, Marshall Islands and Monaco). Officials said Gibraltar had signed no Tax Information Exchange Agreements (TIEAs) under which territories agree to co-operate in tax matters.

A report by the International Monetary Fund last year (see www.imf.org/external/pubs/ft/scr/2007/cr07157.pdf) said the 'principal anti-money laundering risk to Gibraltar is lodged in its professional sector, which is likely to be involved –wittingly or not– in the layering and integration of proceeds of crime'.

The move against Gibraltar came after Gibraltarian and British authorities were criticised by Spain in February for failing to secure a stricken ship in disputed waters off the peninsula. The vessel eventually broke up, causing an oil spill on Spanish beaches. The Spanish government summoned the British ambassador in Madrid for an explanation.

Spanish officials, however, said the latest move did not represent a hardening of policy against Gibraltar as the government wanted tougher measures against all uncooperative tax havens and not just Gibraltar, although the Spanish economy is particularly affected by the Rock. Denmark has also been asking some hard questions about Gibraltar.

Gibraltar's average gross direct investment in Spain (excluding Special Purpose Entities) between 2002 and 2005 represented €88 per inhabitant of the tiny territory, 86 times higher than the average of the five largest EU countries investing in Spain. Such an extraordinarily level of investment has aroused the suspicions of the Spanish authorities.

During the previous Socialist government, Madrid decided to put aside its sovereignty issue and pursue a charm offensive through a Tripartite Forum (known as 'two flags, three voices'). This led to a long overdue agreement for joint use of Gibraltar's airport and direct flights to the Rock from Spain for the first time as of 2006, as well as agreements on some other contentious issues.

In a 2002 referendum 99% of Gibraltarians rejected a shared sovereignty deal with Spain.

More Support for Afghanistan

The outgoing parliament approved the sending to Afghanistan, after the event, of four unmanned aerial vehicles (UAVs) and 36 specialists to operate them. José Antonio Alonso, the Defence Minister in the last government, invoked an article of the national defence law for the first time, which enabled the sending of military personnel to be approved *a priori*.

Spain has around 770 troops in Afghanistan, but they are forbidden by the government from fighting the Taliban except in very special circumstances under their rules of engagement (see Figure 1). The government is reluctant to send more troops or ease its rules of engagement.

Figure 1. International Security Assistance Force Troops in Afghanistan

Country	Number	Country	Number
US	15,000	France	1,515
UK	7,800	Poland	1,100
Canada	2,500	Australia	700
Germany	3,210	Spain	778
Italy	2,880	Rumania	535
Netherlands	1,650	Others	4,338
Turkey	675	Total	42,571

Source: Nato.

Brazil and Spain End Spat over Immigration Controls

Spain and Brazil resolved their differences over immigration controls which led to around 800 Brazilians being turned back at Madrid's airport since the beginning of the year and some Spanish tourists, in a retaliatory move, being refused entry into Brazil for not meeting documentary and financial requirements.

The two sides were keen to defuse the row and prevent it spoiling the otherwise excellent relations between the two countries. Spanish companies and banks have invested heavily in Brazil, Spanish is increasingly being taught in schools and around 200,000 Spaniards go on holiday to Brazil every year.

The Brazilians were turned back because they failed to meet all the entry requirements for non-EU citizens.

Spanish and Brazilian police will work together in some airports in both countries.

Spain's Official Development Assistance Rises the Most

Spain's net Official Development Assistance (ODA) grew the most in 2007 among OECD countries. It rose from 0.32% of GDP in 2006 to 0.41% last year, the ninth largest on this basis (see Figure 2). The government aims to reach 0.7%, the target set for wealthy nations by the UN, in 2012.

Figure 2. Net Official Development Assistance as a % of GDP and in US\$bn, 2007

Country	% of GDP
Norway	0.95
Sweden	0.93
Luxembourg	0.90
Denmark	0.81
Netherlands	0.81
Ireland	0.54
Austria	0.49
Belgium	0.43
Spain	0.41
Finland	0.40
France	0.39
Germany	0.37
US	0.16

Source: OECD.

Domestic Scene

Zapatero Sworn in as New Prime Minister with no Support from Other Parties

José Luis Rodríguez Zapatero was sworn in as Prime Minister for a second term in office without the backing of other parties. As the Socialists, with 169 of the Congress's 350 seats, failed to get the support of any of the other nine parties in parliament to give them an absolute majority (176 seats), Zapatero had to go to a second round of voting at which only a simple majority was required. This was the first time this had happened in Spain's 30-year democracy.

Unlike in 2004, Zapatero preferred being sworn in this way rather than seeking formal alliances with other parties and being beholden to them as he was in his first term in office. When he became Prime Minister with 164 seats he was sworn in with the support of the Catalan Republican Left (ERC), which wants independence for Catalonia, the United Left (IU) and other smaller parties. This support, which created Spain's most leftist government since the pre-civil war Republic in the first half of the 1930s, alienated the conservative Popular Party (PP), the main opposition, and made agreements with them virtually impossible.

Nine of the 17 Ministers in the new government are women, two of whom occupy the newly created posts of Equality and Research and Development and another is Defence Minister (the first time a woman has held this post). María Teresa Fernández de la Vega remains as First Deputy Prime Minister and Minister of the Presidency and nine other ministers remain in the same or slightly restructured posts including Pedro Solbes (Economy), Miguel Ángel Moratinos (Foreign Affairs) and Alfredo Pérez Rubalcaba (Interior). The new Industry, Tourism and Commerce Minister is Miguel Sebastián, the

former head of Zapatero's economic office who was the Socialists' unsuccessful candidate to be mayor of Madrid in last year's municipal elections.

Seeks Consensus to Combat Basque Terrorist Group Eta

The new Socialist government will make a fresh effort to forge a pact with the Popular Party (PP) against the Basque terrorist group Eta. The failure to engineer this during its first term in office was one factor that polarised political life.

The government believes Eta has been considerably weakened since ending its ceasefire more than a year ago, but that it faces a renewed cycle of violence. Eta killed a former Socialist town councillor last month, shortly before the 9 March general election, and set off a car bomb in front of the civil guard barracks in Calahorra.

The PP persistently attacked the previous Socialist government for seeking to end Eta's 40-year campaign of political violence for an independent Basque Country through some kind of peace process and without calling on it to first lay down its arms. This process (whose details have never been made public) got nowhere and Eta went on the offensive again.

PP backing of the government's anti-terrorist policy would give the Socialists greater legitimacy to combat Eta; the party lost the election but still won more seats (154 in the 350-seat Congress) and a greater share of the vote (40%) than in 2004. Zapatero and Mariano Rajoy, the PP leader, seem more disposed towards striking some kind of deal on matters of state than in the previous Socialist government. Spaniards were noticeably fed up with the confrontational politics during the last government.

Not only has Eta been weakened by arrests, the seizure of arsenals of weapons and the blocking in Switzerland of some €3 million in bank accounts (said to come from extortion), but the Basque Nationalist Party (PNV), which heads the Basque government and is pressing for greater autonomy, did badly in the general election. The PNV lost more than 100,000 votes, mainly to the Socialists, who won a record 38.1% of the votes cast in the region. The surge in the non-nationalist vote to well over half the total number of votes is a significant new factor as it occurred when Eta sympathisers called for an election boycott as their parties were barred from running because of their links with the group.

Despite the loss of support, the Basque Premier, Juan José Ibarretxe, still intends to push ahead with an illegal referendum later this year on the issue of making the Basque Country a 'freely associated' state with Spain, overruling the national parliament's rejection in 2005 of such a move. Only one in three respondents in a recent survey in the Basque country (carried out before the election) said they thought Ibarretxe's idea was a good one.

The Socialists' anti-terrorist pact would be based on several elements: the police, who are having increasing success; court cases against Eta's supporters other than their activists; isolating its political supporters (the leaders of the outlawed Batasuna party are already in prison and successor parties banned); and international cooperation.

In another development, the Spanish flag was flown for the first time in 30 years at the Bilbao town hall alongside the Basque flag. The Higher Court of the Basque Country ordered the municipal government last November to comply with the law on flags by the end of March. Until then, the Spanish flag was only briefly flown one day a year.

Mariano Rajoy to Stay as Leader of the Popular Party

Mariano Rajoy, the head of the conservative Popular Party (PP), who has twice lost a general election, said he would remain as leader of the main opposition party and vowed to be its candidate in the 2012 general election.

Rajoy was quick to dampen speculation within and outside the PP that he would bow out of front line politics. Various pro-PP newspapers and commentators on pro-PP TV channels called for Rajoy to resign. Although he failed to lead the PP to victory, the party increased its share of the vote and the number of its seats in Congress (see *Inside Spain*, Newsletter 43, 12 March 2008).

The PP will hold a congress in June at which Rajoy said anyone was welcome to put themselves forward as the party's leader. Several of the PP's 'barons' (regional premiers) are known to be eyeing the party's top job. By stamping his authority on the party soon after the PP's electoral defeat, Rajoy put a lid on dissent. How long this lasts is an open question.

Popular Party Mounts Offensive Against Civics Course

Emboldened by a court ruling in Andalucia, controlled since 1981 by the Socialists, the regional governments of Valencia, Murcia and Madrid, in the hands of the Popular Party, have gone on the attack against an obligatory civics course in secondary schools.

The Higher Court of Andalucia ruled in favour of a student who did not want to take the course because of 'philosophical or religious reasons'.

The Education for Citizenship course, introduced last autumn and aimed at developing the capability for thoughtful and responsible participation in political, social, economic and cultural life, was part of an education reform approved by all parties in 2006 except the PP.

Spanish bishops, backed by the Vatican, opposed the course at the time, saying it would 'form the moral conscience of students' and that the state should remain neutral in such matters as no one had the right 'to impose a moral formation that is not chosen'. At the heart of the Church's opposition was its belief that the state was undermining its position (a monopoly during the Franco regime) as the country's authority on matters of morals.

The first stone against the course, which exists in other European countries, was thrown by Esperanza Aguirre, the premier of Madrid, shortly before the 9 March general election when she said she would allow parents to boycott the course. After the PP's defeat in the election, Francisco Camps, the premier of the Valencian government, said alternative activities would be provided for students who objected to the course and that the course itself would be given in English, something that would be very difficult to achieve as there are not enough competent teachers in the relevant field. The government of Murcia said it too would provide alternative activities.

Both Aguirre and Camps are seen as potential new leaders of the PP if the party's leader, Mariano Rajoy, steps down or is forced out.

Barcelona Faces Water Shortage Crisis

Barcelona (population 1.6 million) is running out of water because of Spain's severe drought, and the regional government is at loggerheads with the central government (both Socialist controlled) for rejecting its solution to the problem –siphoning off water from the Segre, a tributary of the Ebro–.

Alternative solutions under study are to bring it by ship or train from areas of Spain with a plentiful supply of water.

Catalan socialists believe their colleagues in Madrid are reluctant to authorise their solution because in 2004 they scrapped the plan of the previous Popular Party government to divert water through a 540-km canal network from the Ebro River south along the Mediterranean Coast to the Júcar, Segura and south Almería basins and north to the internal basins of Catalonia, and they would be accused of hypocrisy.

The government replaced the PP's scheme with the building of desalination plants in Almería. The first wave of six plants are supposed to come on stream at the end of 2008. Even if they were already open they would not solve the problems, which water experts say are more political than technical.

Two-month Justice Ministry Strike Ends

A strike by Justice Ministry officials, which prevented tens of thousands of hearings, trials and judicial questionings from going ahead and the processing of mountains of paper work, ended after 62 days.

The strike began on 4 February in the Justice Ministries of seven regional governments –Asturias, Baleares, Castilla y León, Castilla-La Mancha, Extremadura, La Rioja and Murcia– where salaries are lower than those in regions where responsibility for the judiciary has been devolved by the central government. The strike was ended after a pay deal to close the gap was accepted.

The Spanish justice system moves slowly at the best of times, even though it has roughly the same number of judges and magistrates per 100,000 people (10.3 in 2006) as France and Germany. Among the reasons for this are obsolete information technology (unlike the Tax Agency's latest generation IT system, a model of its kind) and the poor coordination between the central government's Justice Ministry and the administration in regional governments. The number of sentences waiting to be executed reached almost 1.5 million, 406,665 of them penal, at the end of last September (four months before the strike).

In a separate development, José Antonio Alonso, the former Defence Minister and the Socialists' spokesman in the new Congress, and Mariano Fernández Bermejo, the Justice Minister in the last and new government, are to seek a pact with the opposition Popular Party (PP) to end the long-running crisis in the *Consejo General del Poder Judicial* (CGPJ), the governing body of the judiciary, and in the Constitutional Court.

The mandates of the CGJP members (mostly pro-PP) expired 15 months ago, but there has been no agreement (for partisan reasons) on new members. In the Constitutional Court, the Socialists in 2007 challenged the authority of some PP members to decide on issues, including whether the new Catalan autonomy charter was constitutional or not (the PP says it is unconstitutional), and the PP did the same to some Socialist members. Both these bodies are ‘parliamentarised’ –members are appointed in accordance with the strength of the main parties in parliament and not just on their professional abilities–. Spain has lawyers’ associations clearly identified with the two main parties. As a result, the judiciary has become increasingly politicised.

Alonso and Fernández Bermejo face a difficult task as there is no legal mechanism in place to resolve the problem in the CGJP.

Some lawyers believe the time has come to eliminate the CGJP and return management of the judiciary to the Justice Ministry of the central government (as it was during the Franco regime). Provided the Ministry was solely administering a management service based on clearly defined rules, the executive could not be accused of political interference. These lawyers believe that instead of forming part of the system of checks and balances that all democracies require, the CGJP operates more as an element of imbalance and has contributed to the polarisation of political life.

The Economy

Government Promises Measures to Reactivate the Economy

The Socialists took office with promises to reactivate a fast-shrinking and lopsided economy. The property market has landed with a bump and the fall out from it and the international credit crunch caused the International Monetary Fund (IMF) to forecast GDP growth this year of 1.8%, less than half the pace of 3.8% in 2007. The Bank of Spain was more optimistic and predicted growth of 2.4% (see Figure 3).

Spain’s slowdown is the sharpest among developed countries apart from the US. The last such deceleration was in 1993 when the Spanish economy shrank 1.3% after growing 0.9% in 1992.

Figure 3. Latest GDP Growth Forecasts for Spain in 2008 (%)

	Growth forecast (%)
IMF	1.8
OECD	2.5
European Commission	2.7
Spanish government	3.1
Bank of Spain	2.4
Banco Bilbao Vizcaya Argentaria	1.9

Source: Entities.

Among the government’s measures are an ambitious public works programme to build more affordable homes and infrastructure, schemes to retrain people who lose their jobs in the construction sector (which generated at its peak around 18% of GDP) and a €400 tax rebate for all contributors.

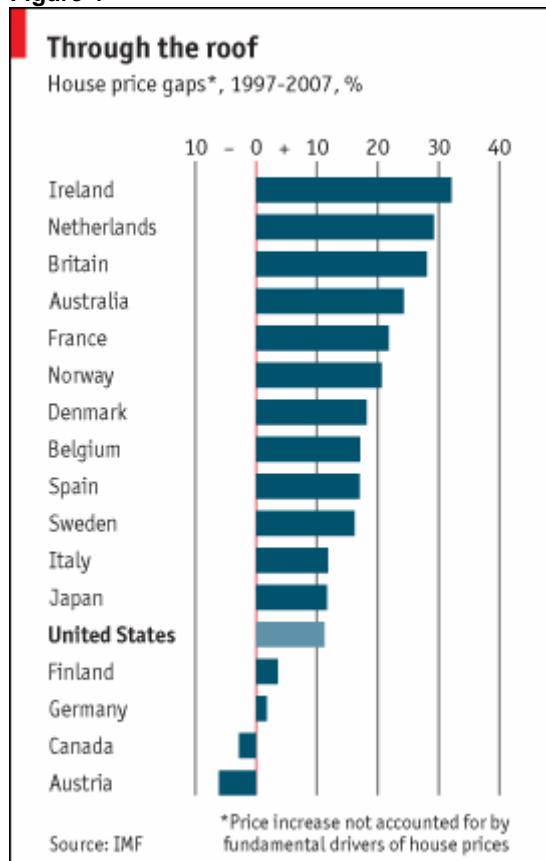
Completed house sales plummeted 27% year-on-year in January, according to the National Statistics Institute (INE) in the first official confirmation of the extent of the property sector's decline. Total lending to home-buyers fell almost 28% to €13.4 billion, the largest decline since INE began to release these figures in 1995.

The number of sales was close to 62,000 fewer than in January 2007: sales of homes and apartments were down 35% to 32,400 units and new homes sales were 15% lower at 29,400. The number of permits to build apartment blocks and houses authorised in January was 29,555, half the number in the same month of 2007. The Bank of Spain forecast negative growth of 0.2% in investment in the construction sector this year (-1.2% in 2009).

Tighter lending conditions and declining consumer confidence, in the face of Spain's economic downturn after a more than decade-long boom during which house prices rocketed, are exacerbating the problems of massive oversupply in the property sector. In 2006, the number of housing starts in Spain (760,000) was more than France, Germany and the UK combined.

In the latest *World Economic Outlook*, Roberto Cardarelli of the International Monetary Fund (IMF), estimates that Spain's house prices are close to 20% higher than can be justified by fundamentals (see Figure 4). This 'house-price gap' –the share of the increase in real house prices between 1997 and 2007 than cannot be accounted for by factors such as lower interest rates and rising incomes– is greatest in Ireland.

Figure 4



An increasing number of Spain's small and medium-sized developers and builders are entering temporary receivership. Developers are reportedly renegotiating €16 billion of loans from Spain's commercial and savings banks. The banks currently have a low level of bad debts and are well provisioned against non-performing loans, but they are bound to rise in the coming months.

Aguirre Newman, the property consultants, said residential estate developments in some parts of the Mediterranean coast now take an average of four years to sell, compared with a few days at the peak of the property boom four years ago. It said about half of the new apartments on the Costa del Sol were unsold.

According to economists, around 600,000 jobs will be lost in the construction sector in 2008 and 2009, many of them held by immigrants. This sector has already shed 100,000 jobs since last summer. The government, worried about the situation of immigrants and the creation of fertile ground for racism during Spain's economic downturn, said it would help those immigrants who lose their jobs to voluntarily return to their home country. In a report this month (*España: Entre la Desgana y la Invisibilidad*, www.es.amnesty.org/uploads/ttx_useratypdb/Informe_racismo_abril_08.pdf), Amnesty International in Spain said the government's plan, approved last year, to combat racism was insufficient and did not take on board the many recommendations made by international organisations. Spain's resident population grew by 5.2 million between 1998 and 2007, 73% of them foreigners.

Rodríguez Zapatero vowed not to reduce social spending. The Bank of Spain estimates the general government budget surplus will drop to 1.2% of GDP this year from 2.2% in 2007, giving the government some leeway. The research department of BBVA, Spain's second-biggest bank, is less optimistic: its forecast for the budget surplus is 0.3% of GDP. Zapatero said the minimum pension for couples would rise to €850 a month and dependent care spending would increase substantially.

Current Account Deficit Surpasses €100 Billion, Inflation Reaches New High

Spain's current account deficit exceeded €100 billion in 2007 for the first time and at just over 10% of GDP was the highest in relative terms among the world's leading economies (see Figure 5).

The deficit in the current account, which records the country's economic transactions with the rest of the world, widened by 25% over 2006 to €106.2 billion. It reflected a very high trade deficit (9.4% of GDP) and household and corporate investment much higher than national savings. Imports were 8% higher at €280.4 billion and exports 6.8% more at €181.4 billion. The export/import ratio was two percentage points lower at 64.7%.

The last time that Spain had a current account deficit of this order was in the early 1990s; it was followed by a relatively mild recession in 1993 and several devaluations of the peseta. As a euro country, Spain can no longer devalue its currency. The adjustment will have to come through other means.

The income line of Spain's current account –which includes interest payments and receipts– showed a €32.91 billion deficit, up 57% from €20.98 billion in 2006.

Figure 5. Current Accounts of Leading Economies in 2007 (% of GDP)

	Current Account
France	-2.2
Germany	+5.3
Italy	-2.2
Japan	+3.9
Spain	-10.2
UK	-3.1
US	-6.1

Source: IMF forecasts except Bank of Spain for Spain.

Inflation was 4.5% year-on-year in March, the highest level since July 1995, according to preliminary figures.

BA Lifts its Stake in Iberia

British Airways (BA) increased its stake in Iberia, the Spanish flag carrier, to 13.15% from 10.14%, and said it may lift it further. BA took advantage of Iberia's lower share price and paid €67.3 million for 28.7 million shares.

BA is one of a group of core shareholders formed when Iberia was privatised and which held a combined stake of 36.13% before BA's latest purchase. Under Spanish take-over rules, the maximum shareholding the core shareholders can buy in any 12-month period without triggering a mandatory bid is 5%.

OHL Wins €127 Million Motorway Contract in the US

Community Asphalt, the US subsidiary of OHL, one of Spain's biggest construction companies, won a €127 million contract to reform a motorway in Florida.

Canary Islands Court Declares 22 Hotels in Lanzarote Illegal

One-third of Lanzarote's most luxurious hotels were illegally built, according to the Higher Court of the Canary Islands which annulled 22 hotel licences. All of them face demolition. Charges against the hotels were brought by the Council of Lanzarote and the César Manrique Foundation.

Spain's Tax Wedge Thins Slightly

Spain's tax wedge –the gap between what employers pay for labour and what workers take home in after-tax pay including any cash benefits from government welfare programmes– eased slightly in 2007, according to the OECD's annual survey of employment taxes. At 38.9% of total labour costs for a single person without children on average earnings, Spain's tax wedge was higher than the UK's but well below Italy's (see Figure 6).

Figure 6. Gap Between Labour Costs and Take-Home Pay (as % of total labour costs*), 2007

	Total Tax Wedge
Belgium	55.5
Hungary	54.4
Germany	52.2
France	49.2
Italy	45.9
Spain	38.9
UK	34.1
US	30.0
Mexico	15.3

(*) Single person without children on average earnings.

Source: OECD.

In theory, the larger the wedge, the greater the barriers to job creation. Spain's relatively high wedge, however, does not seem to have affected job creation: between 2004 and 2007 Spain created many more jobs than any other EU-25 country. This was essentially due to two factors: a booming economy during this period and the fact that one-third of payroll jobs are temporary and not permanent.