



Inside Spain 45

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Foreign Policy

Spain to Assume Command of UN Peacekeepers in Lebanon

A Spanish general will take command of the 15,000 UN peacekeeping troops in Lebanon this September. Spain's 1,100 troops in the country are the third-largest number after Italy (2,500) and France (1,480) and it will deploy more of them in order to meet its new responsibilities.

Carme Chacón, the new Defence Minister, announced the decision during her visit to Spanish troops. She also went to Afghanistan to see Spain's more than 700 troops there. Over the past 20 years Spain has sent more than 100,000 troops to 30 countries in peacekeeping missions.

Six soldiers serving with the Spanish army (three of them Colombian) were killed in Lebanon last June when a roadside car bomb destroyed their armoured personnel carrier. It was the first attack of its kind against the 13,000 strong UN force in the country by a Sunni Muslim group attached to al-Qaeda.

As well as the threat from al-Qaeda, Spain's troops in Lebanon have been accused in pro-Syrian media of spying on Hezbollah for Israel. Military authorities deny this.

Court Rejects Request to Extradite Former Argentine President

The *Audiencia Nacional* court rejected the petition by Argentine judges to extradite María Estela Martínez, the 77-year-old widow of General Juan Domingo Perón, who succeeded him (1974-76) as President of Argentina.

The Court said there was no new evidence to prove her involvement in the disappearance of people during the 1970s. This was the third attempt to have her extradited.

Domestic Scene

Pipeline to Save Barcelona from Water Rationing Angers Other Regional Governments

The first measure to be approved by the new government of José Luis Rodríguez Zapatero, which took office last month, was to authorise the urgent construction of a 62km pipeline at a cost of €180 million to carry water from the River Ebro to drought-stricken Barcelona (population 1.5 million), the capital of Catalonia.

The move angered the heads of regional governments further down the Mediterranean coast in Valencia and Murcia, who said they would take the issue to the Constitutional Court and demand equal access to the Ebro as these regions are also suffering from the effects of drought, though not as severely as Barcelona.

‘If we don’t act, the citizens of Barcelona will be without drinking water in October’, said First Deputy Prime Minister María Teresa Fernández de la Vega. Reservoirs in Catalonia, after a four-year drought, are close to emergency levels. The pipeline is due to be completed just before water rationing would have to begin. Contingency plans have been made to bring water to Catalonia by sea in May and by rail in August if needed.

Catalonia, like the central government in Madrid, is ruled by the Socialists, while Murcia and Valencia are in the hands of the opposition Popular Party (PP). The first Zapatero government cancelled in 2004 the PP’s plan to divert water through a 540-km canal network from the Ebro south along the Mediterranean Coast. The new scheme uses an existing network of pipelines diverting water from the River Segre –a tributary of the Ebro– for agriculture.

In a war of words with the Socialists, the PP said the pipeline, like its more ambitious project to solve Spain’s persistent water problem in the dry parts of the country, was a transbasin diversion (*trasvase* in Spanish) as it diverted water from one catchment to another. The government preferred to call it a *conducción* (pipe). Water experts said there was no doubt it was a *trasvase*. This was more than a question of semantics: were the government to use the word *trasvase* the PP would accuse them of hypocrisy as its scheme never went ahead.

Water rights for the pipeline would be bought from farmers on the Ebro delta. Many of them, however, say they cannot stop irrigating to lay new pipes now that the growing season is under way. The delta is renowned for growing rice, an essential ingredient in local dishes and whose world prices have recently surged. The pipeline would cease to operate once a desalination plant in Barcelona came on stream (scheduled for June 2009).

Felipe González, the Socialist Prime Minister from 1983-96, waded into the heated debate in an article in *El País* calling for a national water policy agreed among all regions and political parties, something that still seems far off.

Government Moves to Grant Faiths other than Catholicism Greater Rights

The government announced it would reform the 1980 Religious Freedom Law in order to enhance the rights of faiths other than the country’s predominant Catholic religion and ease the discrimination they suffer regarding financing, religious education in schools and legal protection of their places of worship. The move, announced by María Teresa Fernández de la Vega, the deputy Prime Minister, is very much in line with the Socialists’ attempts to make Spain a more secular country.

There are estimated to be around 1.5 million Muslims in Spain (between immigrants, the inhabitants of the North African enclaves of Ceuta and Melilla and Spaniards who have converted to Islam), 1.4 million Protestants (including retired EU citizens living in Spain) and significant numbers of Buddhists, Jews, Mormons, Jehovah’s Witnesses and other beliefs.

Since the death of General Franco in 1975, Catholicism is no longer the official religion in Spain. During the 36-year dictatorship, the Church enjoyed considerable privileges and influence, particularly in education.

Under the 1992 cooperation agreement between the Islamic Commission and the state, Muslims (who numbered around 500,000 10 years ago) were granted a series of rights but very few of them have been put into effect. Catholicism is still the only religion that taxpayers can give money to via their annual tax return (by ticking a box). The percentage contribution rose from 0.52% to 0.7% last year. The Church will also receive this year €153 million for the salaries of priests (some 20,000) and bishops (79) and €4,500 million for religion teachers and schools, hospitals and charities they run. In contrast, six other faiths will receive €4.5 million this year.

Almost all of the 500 registered mosques operate out of garages or other premises. Only nine of them were purpose built because of the difficulties encountered in buying land, obtaining the necessary permits and opposition from nearby residents.

Although one-quarter of the 191 people killed by Islamist radicals on March 11, 2004 were immigrants, some of whom were Muslim, the Catholic Church was entrusted with the funeral service.

Judge Jails Mayor for Her Alleged Links with Basque Terrorist Group Eta

Judge Baltasar Garzón imprisoned Inocencia Galparsoro, the mayor of Mondragón, for allegedly cooperating with the violent Basque separatist group Eta. Galparasoro belongs to the Basque Nationalist Action (ANV) party, which was banned from taking part in the 9 March general election.

Since the outlawing of the party, Galparsoro and the other ANV town councillors have exercised their responsibilities personally. Garzón said the mayor continued to act in ANV's name and follow Eta's guidelines.

The mayor has been the focus of national attention since 7 March when a former Mondragón Socialist town councillor, Isaías Carrasco, was shot several times in the back of the head when he left his home. Unlike other parties, the ANV refused to condemn the murder (long the policy of Eta's political allies).

Spain, 'Important Transit Point and Logistical Base for Terrorists in Western Europe'

Four years after the Madrid train bombings by Islamic extremists, Spain remains on a heightened state of alert as the country is an important transit point for terrorists in Western Europe, according to the US State Department's annual survey of terrorism.

The report said Spain was cooperating closely with the US to investigate and prosecute acts of terrorism and to prevent future attacks, and had worked hard to disrupt terrorist acts that possibly were directed against US interests. Spain was the first EU country to sign an arrangement for the exchange of screening information on known and suspected terrorists.

The country's 'geographic location, large population of immigrants from North Africa, and the ease of travel to other countries in Europe, made Spain a strategic crossroads for international terrorist groups and an important staging point for North African extremists heading to Iraq to join the insurgency'. The Spanish government, the report

said, feared that experienced terrorists may soon make their way back to Spain in a reverse terrorist pipeline.

As of last November Spain held a total of 139 terrorist suspects, either under a prison sentence or awaiting trial.

The Economy

Government Sharply Reduces its GDP Growth Forecast, Unemployment Rises

Pedro Solbes, the Economy Minister, substantially lowered the economic growth forecast for the year from 3.1% to 2.3%, moving it closer to the International Monetary Fund's even lower estimate of 1.8%.

Meanwhile, the unemployment rate rose to 9.6% at the end of March from 8.6% at the end of 2007. The government's jobless rate forecast of 9.8% for the end of 2008 already looks to be very optimistic. Economists expect the rate to surpass 10% this year (the official forecast for 2009). The number of unemployed rose by 246,600 in the first quarter, most of it in the construction sector. On a seasonally-adjusted basis, Spain's jobless rate is now the second highest in the EU-27 after Slovakia (see Figure 1). The only positive element was the drop in the proportion of workers with temporary contracts to 30.1%, the best figure since 1990, but still by far the highest level in the EU.

Figure 1. Seasonally Adjusted Unemployment Rates (%)

	March 2007	March 2008
France	8.6	7.8
Germany	8.6	7.3
Italy	6.1	6.1 (1)
Spain	8.1	9.3
UK	5.5	5.1 (2)
EU-27	7.3	6.7
EU-15	7.5	7.1

(1) December 2007.

(2) January 2008.

Source: Eurostat.

More than one-third (97,000) of the 246,600 people who lost their jobs in the first quarter were immigrants. Their jobless rate rose from 12.3% at the end of 2007 to 14.6% in March while that of Spaniards increased from 7.9% to 8.7%.

The slowdown in the economy is much more intense than most experts envisaged (car sales, for example, fell 11.7% year-on-year in the first four months of 2008) and this is reducing the volume of tax receipts. The general government surplus in the first quarter was 0.29% of GDP, half the level of a year earlier and compared to a final figure for 2007 of 2.2%. Solbes says he is determined to record another surplus this year, albeit a much smaller one. This may be difficult to achieve and at the same time meet social expenditure targets.

According to a report by La Caixa, the debt of Spanish households more than doubled in proportion to disposable income between 1996 and 2007 but at 120% was still lower than levels in the UK (164%), the US (138%) and Canada (127). Nearly 80% of Spain's household debt goes into acquiring real estate, a higher percentage than in the US or Canada, where borrowing to finance consumer goods carries more weight. The Bank of

Spain said the proportion of gross available household income allocated to financing the purchase of homes had risen from 43.3% in the first quarter of 2007 to 46.2% a year later.

Property prices rose 4% year-on-year in March according to the Housing Ministry, the first fall in real terms since 1997 as inflation during this period was 4.5%. Real estate experts say the fall in prices is larger because the Ministry's figures are based on those declared officially (it still common practice for the notarised price to be lower than the actual price paid).

Some relatively small real estate developers have entered temporary receivership while others are trying to sell their properties at cost, foregoing any profits.

Spanish Banks Continue to Buck the International Trend

Spain's five largest banks increased their combined profits by 6.2% in the first quarter, clearly bucking the trend of lower earnings or losses at banks in the US, the UK and some other countries because of the fall out from the US subprime crisis and the liquidity crunch. Their volume of Spanish banks' non-performing loans (NPLs) is also relatively small, though growing because of the slowdown in the economy as a whole and the property sector in particular, after a decade-long boom.

Santander, the largest bank in Spain and biggest in the euro zone by market capitalisation, increased its attributable profit by 22% year-on-year to €2.2 billion and by 14% on a like-for-like basis excluding the incorporation of the banks it acquired (in Brazil and Italy) as a result of its take-over last year of the Dutch bank ABN AMRO in a consortium with Royal Bank of Scotland and Fortis.

Santander's NPL ratio, however, rose from 0.82% in March 2007 to 1.16% a year later, but this was still around half the international level. NPL coverage with provisions dropped from 177% to 133% (the international level is less than 80%). Thanks to the Bank of Spain's counter cyclical policy in provisions over the last few years, the starting point of banks is a strong one.

Pedro Solbes, the Economy Minister, however, warned of a rapid rise in NPLs as a result of the liquidity problems in companies related to the construction sector and the increasing difficulties faced by these firms and families in servicing loans and mortgages.

The profits of BBVA, Spain's second largest bank, rose by almost 15% to €1.4 billion. Its NPL ratio rose less than Santander's (from 0.84% to 0.98%). An increasing share of Santander's and BBVA's profits are coming from the banks they own abroad, particularly in Latin America.

As a result of its share price falling by a smaller extent than other major international banks, Santander moved up the ranking of world banks by market capitalisation to eighth place at the end of April (see Figure 2). BBVA was ranked 14th.

Figure 2. Ranking of World Banks by Market Capitalisation (1)

	€ Million
Industrial and Commerce Bank of China	190,840
China Construction Bank	136,912
HSBC Holdings	130,237
Bank of America	108,186
Bank of China	107,738
JP Morgan Chase ¹	102,885
Citigroup	89,106
Santander	85,496
BBVA	55,132

(1) At 29 April 2008.

Source: Bloomberg.

Santander Buys 2.3% of Royal Bank of Scotland

Banco Santander came to the rescue of the ailing Royal Bank of Scotland (RBS), an old ally, and acquired a stake of 2.3% for €1.36 billion. Santander sold its stake of just over 5% of RBS in 2004 and 2005 after buying the UK bank Abbey.

Santander's move came as RBS, hit by the damage wrought on its balance sheet by the credit crunch, sought to raise £12 billion from shareholders in Europe's largest ever rights issue and £4 billion by selling assets, including its insurance arm.

RBS's problems began last summer, just as the credit crisis was emerging, when it joined forces with Santander and Belgium's Fortis to buy the Dutch bank ABN AMRO. Under that deal, Santander was allotted Brazil's Banco Real and Italy's Banca Antonveneta (since sold for a juicy capital gain). As well as returning to RBS and becoming its third largest shareholder, Santander also acquired 2.1% of Fortis for €1,190 million.

Spain's High-Tech Exports Among the Lowest in the EU-25

The high tech exports of Spain –which needs to develop an economy based much more on knowledge and less on bricks and mortar– accounted for less than 6% of the country's total exports in 2007, one of the lowest figure in the EU (see Figure 3).

Figure 3. High-Tech Exports of Selected EU-25 Countries (1)

	% of world high-tech exports	% of the country's total exports
Germany	7.9	14.8
France	4.86	19.1
UK	4.68	22.1
Netherlands	4.52	20.3
Italy	1.42	6.9
Finland	0.80	22.1
Spain	0.60	5.7
Czech Republic	0.50	11.7
Poland	0.16	3.2

(1) Including intra-EU exports.

Source: Eurostat.

With the mighty construction sector (18% of GDP at its peak) in the doldrums, the new government hopes to begin to develop a more technologically advanced economy. Among the new ministries it has created is one dedicated to Science and Innovation.

Spain's level of high-tech exports compares badly not only with the other big EU economies, but also with some of the newer members such as Hungary.

Repsol YPF Discovers Potentially Huge Oil Field

Repsol YPF received a big boost in Latin America with the discovery of a major offshore oil field by the consortium in which it has a 25% stake. The other members are Petrobras, the Brazilian operator (45%), and the UK's BP Group (25%).

The Carioca field 'could contain reserves as large as 33 billion barrels of oil equivalent', making it the world's largest find in the past 30 years, according to Haroldo Lima, director of the ANP, Brazil's energy regulator. Analysts were more cautious about the size of the discovery.

The news was very welcome at Repsol which decided last year to reduce its exposure to South America and concentrate on other areas. The company sold 25% of its Argentine and Bolivian division to Argentine businessman Enrique Eskenazi, partly to assuage nationalist sentiment in Argentina against multinational companies following the collapse in 2001 of the economy. That sale valued YPF at US\$15bn, the same price paid by Repsol for the original YPF in 1999, at the peak of the country's economic boom.

Repsol also faced price caps and export controls in Argentina and energy nationalisation in neighbouring Bolivia, leading to a 25% writedown in the company's oil and gas reserves in 2005.