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Foreign Policy

Spain Hosts Mini Summit to Revive the Stalled European Constitution

Spain and Luxembourg staged a ‘friends of the constitution’ conference in Madrid, attended by 22 countries, 18 of which had ratified the constitution and wanted to keep most of its contents. The process of approving the new constitution came to a halt in 2005 when it was rejected by France and the Netherlands, and as a result some other countries decided to put the issue on hold.

Spain was the first country to approve the constitution by referendum. The result was a landslide victory for the ‘Yes’ campaign, with 77% of voters in favour. Turnout, however, was only 42% of the electorate –by far the lowest in any election since the restoration of democracy in the 1970s–.

Germany, which assumed the EU presidency in January, wants member states to agree by the end of 2007 the parts of the constitutional treaty that can be rescued. The countries attending the conference showed a willingness to make changes to the constitution in order to smooth the path for an agreement with France and the Netherlands.

Takes Over as President of the OSCE

Last month Spain assumed the presidency of the Organisation for Security and Co-operation in Europe (OSCE), the world’s largest regional security organisation whose 56 member countries span the geographical area from Vancouver to Vladivostok.

Madrid takes over at the helm at a time when the OSCE, established during the Cold War in the early 1970s when the conference for Security and Co-operation in Europe (CSCE) was created as a multilateral forum between the East and West, is losing relevance because of changes in the security landscape (see www.realinstitutoelcano.org/analisis/1093.asp).

The priorities of Spain’s chairmanship during 2007 are:

- Strengthen the OSCE’s capabilities as a forum for dialogue and cooperation.
- Seek ways to end the conflicts in the region, such as that between Armenia and Azerbaijan.
- Pay particular attention to the fight against terrorism.
- Highlight the importance of the environment.
- Enhance the transparency of democratic processes and an effective rule of law.

¹ The last Inside Spain appeared on 4 December 2006.

The Socialist José Borrell, the former President of the European Parliament, is the special envoy for Spain's chairmanship.

Donates €582 million to the United Nations

The donation of €582 million to the United Nations over the next three years makes Spain one of the main voluntary contributors to the world body. The money will be put at the disposal of the UN Development Programme and used to make progress in the goals set out in the UN's Millennium Declaration such as promoting peace and protecting the environment.

The donation will move Spain closer to the government's goal of dedicating 0.5% of GDP to official development aid. José Luis Rodríguez Zapatero, the Prime Minister, is a firm believer in the UN and multilateralism; one of the reasons for his withdrawal of Spain's peacekeeping troops from Iraq in 2004 soon after taking office was because the US- and UK-led invasion of the country did not have UN support, and he boosted Spain's troop presence in Afghanistan because that international mission is UN-backed.

Spain's official development aid rose 24% in 2005 to €3,011 million, the 10th largest amount in absolute terms (see Figure 1) and one of the biggest rises. According to the Commitment to Development Index, produced by the Centre for Global Development and the US magazine *Foreign Policy*, Spain made the most progress of the 21 countries covered in the index between 2003 and 2006. But at 0.27% of GDP it is still among the lowest in Europe.

Figure 1. Official Development Aid, Selected Countries

Country	In US\$ mn, 2005	% Change 2004-05	As % of GDP	Per Capita (US\$)
United States	24,457	35.6	0.22	92.6
United Kingdom	10,754	34.8	0.48	179.2
France	10,059	17.1	0.47	159.9
Germany	9,915	30.7	0.35	120.2
Sweden	3,280	21.0	0.92	362.4
Spain	3,011	23.6	0.27	68.3
Finland	897	29.2	0.47	170.5
Ireland	692	11.4	0.41	173.0

Source: Intermon-Oxfam.

Intermón-Oxfam criticised countries including Spain for including debt condonation in their official development aid figures which, it said, inflated them. It also pointed out that Cameroon and Uganda, two of the world's poorest countries, were net donors to Spain as they paid back more money in 2005 than they received and Spain was the leading exporter of munitions to Sub-Saharan countries.

Algeria Urges Madrid to Support Independence Referendum in Western Sahara

Algerian President Abdelaziz Bouteflika urged José Luis Rodríguez Zapatero, the Prime Minister, at their meeting in Algiers during December to press for an independence referendum for the territory of Western Sahara.

Bouteflika wants Madrid to press for the referendum in future talks with the Moroccan authorities and the Polisario Front, a rebel group that is seeking independence for Western Sahara, a former Spanish colony in north-western Africa. Morocco rejects the idea of a referendum.

'We hope that Spain will engage in a more resolute manner with Morocco and the

Polisario Front to lead them to accept to prepare the referendum', Bouteflika said. 'Spain cannot remain indifferent to the plight of the people of the Sahara'. This was Bouteflika's clearest reproach yet of Spain's sitting-on-the-fence stance.

Morocco annexed Western Sahara after Spain gave up the mineral-rich territory in 1975. It fought a long war with the Polisario Front and has been in a stand-off with the group since a 1991 UN-negotiated cease-fire overseen by UN troops. Algeria backs the Polisario, whose encampments are in southern Algeria.

Algeria is Spain's main supplier of natural gas, the source of a significant number of illegal immigrants and of concern about terrorism. The Algerian Justice Minister Tayeb Belaiz and his Spanish counterpart, Juan Fernando López Aguilar, signed an agreement allowing for extraditions between the countries. About 70 Algerian terror suspects in Spanish custody could be affected by the accord.

Madrid is in a difficult position over Algeria as it does not want to harm Spain's greatly improved relations with Morocco, particularly the greater cooperation over illegal immigration and terrorism. At the same time, Algeria's strategic importance as an energy supplier is increasing.

Spanish police arrested 11 suspected Islamic militants in the Spanish African enclave of Ceuta who were alleged to be in the early stages of planning a terrorist attack. The operation was carried out in close cooperation with Morocco's secret services. Such cooperation does not yet exist with Algeria.

Domestic Scene

Eta Bomb Blasts Peace Process, PP Spurns New Consensus Against Terrorism

The bomb attack that killed two people at Madrid's airport shattered the nine-month 'peace process' and intensified the divisions between the Socialists and the conservative Popular Party (PP) on how to bring to an end the close to 40 years of violence by the Basque terrorist organisation Eta. The deaths were the first fatalities caused by Eta in three and a half years.

While King Juan Carlos said the political parties had a 'duty and responsibility' to work together to end terrorism and the Prime Minister, José Luis Rodríguez Zapatero, took the unusual step of apologising before parliament for a 'clear mistake' by being too optimistic, one day before the blast on 30 December, about the prospect of peace talks, the PP's position became even more entrenched. José María Aznar, the former PP Prime Minister, compared what he called Zapatero's strategy of 'appeasement' with Eta to that of Neville Chamberlain, the British Prime Minister, towards Hitler before the start of the Second World War.

The PP refused to back the peace initiative, which began after Eta declared a so-called 'permanent' ceasefire last March. It accused the government of being prepared to pay a political price –something that would appear not to be the case, otherwise Eta would not have gone on the attack–. This, however, assumes, that the attack was not carried out by a hardline Eta splinter group as some analysts believe. In a statement Eta blamed the government for 'placing endless obstacles in the way of the democratic [peace] process'. It said peace would be reached 'through a political agreement that recognised

the minimal democratic rights of the Basque country', referring to the group's desire to choose whether to remain part of Spain.

The PP's hardened position since the bombing was epitomised by its refusal to take part in the massive anti-terrorism demonstrations in Madrid and Bilbao, the first time the party had refused to support such a demonstration after Eta had killed someone, even though the organisers agreed to the PP's request to include the word 'freedom' in the slogan chosen for Madrid ('*For peace and against terrorism*').

The PP spurned the government's new offer of working with it unless the Socialists agreed to various conditions including a ban on the Communist Party of the Basque Lands (EHAK-PCTV, with seven seats in the Basque parliament), regarded as a front for the illegal Batasuna, effectively Eta's political wing, and a greater crackdown on Batasuna. The PP's lashing of the government's anti-terrorist policy remains the bedrock of its strategy to win the next election.

Meanwhile, the Supreme Court declared the Basque youth organisations Jarrai, Haika and Segi 'terrorist organisations' for their street violence in the Basque country in support of Eta's cause.

Government Authorises Hiring of More Migrant Workers

The demand for labour is still so strong, despite the influx of immigrants, that the government has authorised the hiring of more than 180,000 migrant workers this year in their countries of origin.

The workers will do the jobs that Spaniards are no longer prepared to do, such as grape harvesting, waiting at table or working on building sites. The number includes 61,000 temporary workers and 92,000 to be recruited by employers. The aim is to provide cheap and legal labour.

A tiny fraction of the number, however, will come from sub-Saharan countries such as Senegal, the main source of the surge in illegal immigration to the Canary Islands during 2006. The more than 31,000 immigrants who arrived in fishing boats in the Canary Islands after surviving the perilous crossing of up to 1,250 miles was four times higher than the number between 2002 and 2005. Much of the recruiting will be done in Morocco: in January businessmen sought 7,000 married Moroccan women to harvest the strawberry crop in Huelva. They only hired married women because this is a guarantee that they will return home after their three-month contract expires. They earn €33 a day, almost 10 times more than for working in their own country's agricultural sector.

Meanwhile, as many as 300,000 illegal immigrants could begin to request legal status during 2007. These people would benefit from a mechanism for regularising their situation known as *arraigo* (literally 'to take root') which is conditional on the irregular immigrants' date of entry into Spain.

Last year the government's extraordinary regularisation campaign turned some 560,000 illegal immigrants into legal ones. Other immigrants were unable to take advantage of the campaign because, among other conditions, they were not inscribed in the local population register before 8 August 2004. Irregular immigrants have an incentive to do

this as it gives them access to healthcare in the municipality in which they reside according to the register. The largest number of illegal immigrants are Rumanians, according to official figures (see Figure 2). Although Rumania and Bulgaria joined the EU in January, their citizens cannot freely work in Spain because of the government's temporary restrictions.

Figure 2. Most Common Countries of Origin in Terms of Irregular Immigration in Spain

Country	Crude Stock of Irregular Immigrants
Rumania	189,821
Bolivia	81,706
Argentina	53,549
Ecuador	42,520
Morocco	41,895
Brazil	40,662
Bulgaria	37,428
Total top 10	728,660

Figures at January 2006.

Source: INE and Ministry of Labour and Social Affairs.

In order to qualify for legal status, irregular immigrants need to meet the three-year residency requirement. Other conditions include a labour contract of more than one year and being able to prove family links with other immigrants in Spain who are legally in the country.

In a separate development, the government signed an agreement with Mali to repatriate illegal immigrants from that country. This is the third such accord with a Sub-Saharan country after agreements with Gambia and Guinea-Conakry last year.

Meanwhile, Spain is the second-favourite country in the world for British people living abroad, according to a study by the Institute for Public Policy Research (see Figure 3). At the last count there were 761,000 Britons resident in Spain.

Figure 3. Britons Abroad: The Top Countries

Country	Number
Australia	1,300,000
Spain	761,000
United States	678,000
Canada	603,000
Ireland	291,000
New Zealand	215,000
South Africa	212,000
France	200,000

Source: Institute for Public Policy Research.

As a result of this influx from different corners of the world, Spain's population was 44.7 million at the beginning of 2006, according to the latest official figures, some 600,000 more than a year earlier (see Figure 4).

Figure 4. Spain's Population 1998-2006 and Foreigners' Share

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Population (mn)	39.8	40.2	40.5	41.1	41.8	42.7	43.2	44.1	44.7
Foreigners' Share (%)	1.6	1.8	2.3	3.3	4.7	6.2	7.0	8.4	11.0(e)

(e) Estimate.

Source: INE.

Spain Fourth Largest Country of Muslims in European Union

Spain's Muslim population of more than 1 million is the fourth largest in the EU and

racist violence and crime is relatively low, according to a report by the European Monitoring Centre on Racism and Xenophobia (see http://eumc.europa.eu/eumc/material/pub/muslim/Manifestations_EN.pdf).

Muslims represent 2.6% of the population, the same proportion as in the UK (see Figure 5). The total number of Muslims in the EU is estimated at 13 million (3.5% of the population). The influx of Muslims into Spain, largely from North Africa, has happened at a much quicker pace than other EU countries.

Figure 5. Main EU Countries with Muslim Populations

Country	Number (mn)	% of population
France	3.51	5.8
Germany	3.40	4.1
United Kingdom	1.58	2.6
Spain	1.06	2.6
Netherlands	0.97	5.7
Italy	0.72	1.2

Source: European Monitoring Centre on Racism and Xenophobia.

The report, which draws on extensive research by many institutions, says Spain's trade unions have been successful in making many companies more flexible towards cultural differences amongst their staff, but migrants in both rural and urban areas face serious housing problems, including homelessness, substandard makeshift accommodation; illegal boarding houses and overcrowding.

In a separate report, a survey conducted for Spain's Interior Ministry by Metroscopia cautiously concluded that Spain's Muslim community is 'particularly tolerant, westernised and liberal' (see www.realinstitutoelcano.org/materiales/docs/comunidad_musulmana_esp_nov06.pdf).

Spain, 'One of the Worst' to be Affected by Global Warming in Europe
Spain and Italy, which have been slow to curb greenhouse gas emissions, will suffer most from 'drought, reduced soil fertility, fire and other climate-change driven factors', according to a study by the European Commission.

Those countries most committed to combating climate change, such as the UK and Sweden, would ironically gain as warmer temperatures would boost crop yields and reduce the number of deaths from cold. And this could affect Spain's vital tourism industry as Northern Europeans would be able to holiday at home instead of going to southern Europe.

Government Approves New Regulations on Catholic Religion Classes in Schools
The Socialists' decision to make Roman Catholic religion classes in schools voluntary and to provide two alternatives, left both the Church and secular segments of society dissatisfied with the new arrangements.

Those pupils who do not opt for the classes will either have a free period or study the history of world religions. The Church will continue to have the right to sack teachers of Catholicism when it sees fit. The long-discussed agreement applies to all schools receiving public funds and to private schools if parents request the options.

'The Church defended, as one would expect, families that want a Catholic education,

but our obligation is to defend everyone and without making the right of those who want to study religion an obligation for everyone else', said Alejandro Tiana, the General Secretary at the Education Ministry.

The Church, which is at loggerheads with the government over other issues such as legalisation of same-sex marriage, did not want the option of a free period as it believes it devalues the option of those who study Catholicism. Meanwhile, secular segments of society, particularly those on the left of the political spectrum, are unhappy at the Church's continued right (under a 1979 agreement) to get rid of teachers. Teachers of the Catholic faith are 'licensed' by the Church but if they separate from their spouses, for example, they are sacked.

The agreement followed a new deal on financing for the Church, the only religion which receives money directly via taxpayers even though Spain now has 1 million Muslims (See *Inside Spain*, Newsletter 28, 4 October 2006). According to the distinguished theologian Juan José Tamayo, Spain still has a long way to go before it is a truly secular state. The matter is not helped by the 1978 constitution, drawn up after the end of the Franco regime, during which the Catholic Church was very powerful, as it states that the authorities will 'maintain the appropriate relations of cooperation with the Catholic Church'. According to a Financial Times-Harris Poll, 84% of respondents in Spain, the second-highest number among the five European countries surveyed, said church and state should be kept separate and only 40%, the second-lowest figure after France (20%), said religion should be taught in schools (see Figure 6).

Figure 6. Do You Believe the Church and State Should be Kept Separate in Modern Europe?					
(%)	UK	France	Italy	Spain	Germany
Yes	70	86	71	84	77
No	9	5	20	9	10
Not sure	21	10	9	8	13

Note: percentages may not add up exactly to 100% due to rounding.

Base: all EU adults in five countries.

Source: Financial Times-Harris.

Law on Reparations for Victims of Civil War and Franco Dictatorship Divides Parliament

The so-called Law of Historical Memory, the first of its kind to honour the memory of the victims of the 1936-39 civil war and the Franco dictatorship until 1975, passed the first stage of its controversial passage through parliament. All parties back the bill, proposed by the Socialist government last July, except for the conservative Popular Party (PP), the main opposition.

The bill bans symbols and references to the Franco regime in public buildings and asks local and regional governments to rename streets or squares that are named after Franco or which refer to his regime. It also prohibits any political event at the Valley of the Fallen, a large monument near Madrid that includes Franco's tomb and is the most potent symbol of his regime.

'Along with increasing the rights of victims, the bill aims to pay off a debt, a debt of injustice', said Deputy Prime Minister María Teresa Fernández de la Vega.

All victims will have a year to request reparations from a commission. A total of €20 million will be made available for payments.

While the PP, with 148 seats in the 350-seat parliament, rejects the bill and calls it ‘hypocritical’, other parties, but not the Socialists, say it does not go far enough. One amendment proposed by three small parties called for the annulment of verdicts reached at trials carried out during Franco’s dictatorship, but the government rejects the idea.

The Economy

Brussels to Take Spain to Court over Battle for Endesa

The European Commission decided to take Spain to the European Union’s highest court for placing obstacles in the way of the bid by Germany’s E.on to take over Endesa, Spain’s largest power company.

The move followed several warnings and stems from a law introduced in February 2006 that granted sweeping new merger control powers to the Spanish energy regulator. The Commission alleges that Spain has violated a fundamental EU principle that guarantees the free movement of capital between member states and the right of establishment.

Meanwhile, the path was finally cleared for Spain’s Gas Natural and E.on to battle for Endesa. The Spanish Supreme Court lifted a court injunction preventing E.on from formally launching its €36.5bn bid and this was followed by a Madrid court ruling on another issue. Gas Natural launched its lower bid, favoured by the government, in September 2005, and E.on followed with its higher offer in February 2006.

There may not, however, be a straight fight between Gas Natural and E.on as Acciona, the Spanish construction group, built up during the wrangling a stake of 24.9% in Endesa, the maximum it can hold under Spanish rules without being forced to bid for more shares. It seems that it wants to influence the running of Endesa without joining the take-over race. E.on and Gas Natural were due to present their offers on 2 February.

Air Comet Takes Over the Routes of Failed Low-Cost Carrier Air Madrid

Air Comet, a subsidiary of the Marsans travel group, is to take over the seven routes that Air Madrid covered between Spain and Latin America before it suspended flights and also employ just over half its staff. The government chose Air Comet over Germany’s LTU charter flight company which had expressed interest.

Air Madrid left thousands of passengers stranded in Spain and Latin America ahead of the Christmas break, forcing the government to charter aircraft and find other flights for the most extreme cases.

The airline faces multi-million-euro claims from 24,000 ticket-holders, and a group of creditors sought to liquidate the company’s assets. State prosecutors also began to investigate whether Air Madrid acted fraudulently by selling tickets after deciding to suspend all scheduled flights.

Telefónica to Invest €5.4bn in Brazil

Telefónica, the world’s largest integrated telecoms company by number of customers, is to invest €5.4 billion in Brazil where it is already a key player. The investment over the next four years will be used to strengthen its position in fixed and mobile telephones and in Internet.

Abertis and Italy's Autostrade Call Off their Merger

Spain's Abertis and Autostrade, Italy's biggest toll-road operator, abandoned their €25 billion cross-border merger because of Italian government opposition.

The tie-up would have created the world's largest highway operator, with about 6,713 kilometres of highways in Europe and the United States under management.

The European Commission said Rome had no right to interfere in a deal that was already cleared by the Commission's antitrust directorate.

Banco Sabadell Acquires Miami-based TransAtlantic Bank

The Barcelona-based Banco Sabadell, Spain's fourth-largest banking group, agreed to acquire the small TransAtlantic Bank for US\$175 million.

Banco Sabadell, with 1,184 branches in Spain, already has a branch and international office in Miami and views South Florida's attractive market as a first step towards building a United States banking business.

Foreign Direct Investment Plummets

Spain received an estimated US\$12.9 billion of foreign direct investment (FDI) in 2006, less than half that in 2005, according to UNCTAD (see Figure 7). Apart from Germany, whose FDI slumped by 75%, Spain suffered the sharpest fall among the EU-15 countries.

Figure 7. FDI Inflows by Selected Host Countries, 2004-2006 (US\$ bn)

Country	2004	2005	2006 (e)
China	60.6	72.4	70.0
France	31.4	63.6	88.4
Germany	-15.1	32.7	8.1
Italy	16.8	20.0	30.0
Mexico	22.3	18.9	18.9
Poland	12.9	7.7	16.2
Spain	24.8	23.0	12.9
Turkey	2.8	9.7	17.1
United Kingdom	56.2	164.5	169.8

(e) Estimated by annualising available data, in most cases the first two quarters of 2006. The proportion of inflows to these economies in total inflows to their respective region in 2005 is used to extrapolate the 2006 data.

Source:UNCTAD.

OECD Warns on Economy, House Prices '30% overvalued'

The long-booming economy faces growing imbalances that threaten to 'derail the strong performance' according to the OECD's latest survey of Spain (see www.oecd.org/dataoecd/6/17/37916699.pdf for the policy brief).

The main issues are:

- The stubborn inflation differential (a cumulative 10 pp with the euro area since 1997), which is continuing to erode competitiveness and helping to widen the trade deficit, highlights the need to improve the functioning of the labour and product markets.
- The very rapid rise in household debt and property market prices, which could jeopardise macroeconomic stability, underline the need to stabilise the housing sector and correct its dysfunctional aspects.

- From a long-term perspective, reforms are still needed to ensure that the public finances remain sound, given the expected consequences of population ageing.
- Maintaining the process of income convergence with the most affluent countries will require a pick-up in productivity growth; this will involve improving the education system, catching up in terms of innovation and the use of new technologies and also eliminating the market distortions hindering the development of higher value added activities.

In order to stabilise the overvalued property market, the prices of which have doubled in real terms since 1998, the OECD says it would ‘no doubt be more effective and less costly to gradually do away with the various forms of assistance to home ownership so as to balance the incentives between renting and purchasing and moderate demand pressures’. This would be politically very unpopular, however.

The OECD welcomed the government’s Ingenio 2010 plan to step up the effectiveness of R&D and innovation policy. It certainly needs to do so. Spain is the only OECD country that spends more on gambling every year than on R&D: in 2005 (latest figure) Spaniards spent about €29 billion on all forms of gambling including the national lottery, or €722 per capita, according to Munich-based Media & Entertainment Consulting Network, while R&D expenditure was one-third of this at €10 billion.

Spain’s Stock Market Best European Performer in 2006, Record Tourists

The Ibex-35 index rose 32% in 2006 to an all-time high of 14,146 points, the biggest rise among the major European benchmarks and one of the largest in the world (see Figure 8). The main drivers were strong corporate earnings and a still buoyant economy.

Figure 8. Best Performing Stock Markets in 2006

Index	% Rise
Mexico	47.9
Bovespa (Brazil)	32.9
Ibex-35 (Madrid)	31.8
Dax Xetra (Frankfurt)	21.9
CAC (Paris)	17.5
Dow Jones (New York)	16.7
MIB30 (Milan)	16.05
FTSE (London)	10.7
Nasdaq (New York)	10.1
Nikkei (Tokyo)	6.9

Source: Bloomberg.

And another record was notched up in tourism. The number of tourists who visited Spain last year was 58.5 million (see Figure 9).

Figure 9. Tourists Visiting Spain

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Tourists (mn)	41.8	45.4	46.4	48.5	50.3	50.8	52.4	55.9	58.5

Source: Secretary of State of Commerce and Tourism.

Meanwhile, the general government budget generated a record surplus of 1.6% of GDP and the number of people with jobs surpassed 20 million for the first time. The unemployment rate (8.3%) was at its lowest level since 1978. Household savings, however, were down to 9.3% of disposable income at the end of September, the lowest level since 1999, reflecting Spaniards’ high spending and level of indebtedness.