

## **Inside Spain 12**

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### **Foreign Policy**

*Spain hosts global conference on terrorism on first anniversary of Madrid terrorist attacks*

UN Secretary General Kofi Annan called for a world treaty on terrorism at the conference in Madrid that was held on the first anniversary of the terrorist bombings that killed 191 people and injured more than 1,500.

The central idea of the conference was that ‘democratic government is the only legitimate –and still the only effective– way of fighting terrorism’. The Madrid Agenda that Annan took with him after the conference was the most comprehensive plan of action yet seen for a democratic response to terrorism.

A common understanding on what exactly constitutes terrorism would enable the UN and other world bodies to fight it jointly and help create laws that would allow for the perpetrators to be prosecuted.

Other leaders that attended the conference included José Manuel Durão Barroso, the president of the European Commission, Afghan President Hamed Karzai and many former heads of state and government. The US sent Alberto Gonzales, the new attorney general and a member of the cabinet. This was a further sign of the thawing of the relations between Madrid and Washington, following the abrupt withdrawal of Spain’s 1,300 peacekeeping troops from Iraq almost a year ago. The US Embassy in Madrid pressed the case with Washington for sending a high level representative and not to lay itself open to accusations of being vindictive.

Gonzales met with his counterpart, Juan Fernando López Aguilar, the justice minister, and agreed to co-operate more closely in the fight against terrorism.

The call by Prime Minister José Luis Rodríguez Zapatero for an ‘alliance of civilisations’, an ill-defined concept to help bridge the gulf between the West and the Arab and Muslim world, first made at the UN General Assembly last September, received backing from two Muslim countries at ceremonies to mark the anniversary of the Madrid attacks. One of them was Morocco, which sent Prince Mulay Rachid, the brother of King Mohammed VI, and the other was Algeria (President Abdelaziz

Buteflika). Most of the 22 people jailed for the attacks are Moroccans. Their trial is not expected until late this year at the earliest.

In a separate move, the Islamic Commission of Spain, the main body representing Muslims, issued a *fatwa*, or Islamic edict, declaring al-Qaeda chief Osama bin Laden an apostate unworthy of his faith. The *fatwa* claimed support from Muslim leaders in Morocco as well as Algeria and Libya.

The six-month Spanish parliamentary commission to investigate the attacks has almost completed its work, but the centre-right Popular Party (PP), which was in power when the bombings took place and ousted three days later when Spaniards elected the Socialists, refuses to endorse the conclusions. Unlike the US commission on 9/11, Spain's commission is partisan. As the majority party, the Socialists control the Commission and rejected the PP's proposals to call certain people and pursue some leads. The political squabbles and point scoring between the PP and the Socialists, basically emanating from the outcome of the election, spilled over into the Commission and were an ugly spectacle, particularly for the victims.

Much greater progress, however, has been made in co-ordinating Spain's security forces and making them better prepared for any future terrorist threats. The police, defence ministry, paramilitary civil guard and National Intelligence Agency (CNI) now exchange notes once a week. A year ago they hardly talked to one another. Clashing databases and incompatible computer programmes are also being integrated.

#### *New US ambassador to Spain in the pipeline*

Eduardo Aguirre, the director of US Citizenship and Immigration Services (USCIS), is likely to be the next American ambassador to Spain, subject to the lengthy ratification process by the Senate. He is not expected to arrive until the summer.

The appointment of Aguirre, a Cuban-American, represents a rise in political profile. His predecessor George Argyros, a non-Spanish speaking billionaire businessman from California, was chosen after making large donations to the coffers of the Republican Party. Argyros left Madrid last November.

The Spanish government has privately welcomed the appointment. Aguirre immigrated to the US as an unaccompanied minor when he was 15. He was one of the 'Pedro Pan' children, a programme started in 1960 and financed by the US government and the Catholic Church, which brought to the US the children of families who were contemplating leaving Cuba. More than 14,000 young people went to the US in what was the largest recorded exodus of unaccompanied minors in the Western Hemisphere. Aguirre's wife, María Teresa, also came to the US under the same programme.

Aguirre joined the Department of Homeland Security from the Export-Import Bank (Ex-Im Bank) and before that he was president of International Private Banking for Bank of America.

According to the latest survey by Elcano, carried out almost one year after the March 14 general election, 59% of those surveyed believe Spain's relations with the US have deteriorated (see [www.realinstitutoelcano.org/barometro.asp](http://www.realinstitutoelcano.org/barometro.asp)). The same survey shows 78% against the sending of troops to Iraq and 68% regard the re-election of George W.

Bush as 'negative for peace and security in the world' (10 points above the average of other countries surveyed).

Miguel Ángel Moratinos, Spain's foreign minister, will make an official visit to Washington on April 15.

*Spain joins Germany and France in forging closer ties with Russia*

Spain has joined Germany and France in the so-called 'informal club of Russia's friends' which seeks to smooth the path for closer relations between the European Union and Russia.

Prime Minister José Luis Rodríguez Zapatero joined Gerhard Schröder and Jacques Chirac in Paris for a meeting with Vladimir Putin. Madrid, Paris and Berlin have forged closer links in the year since Spain's Socialists came to power.

The four countries backed UN resolution 1559 calling on Syrian troops to withdraw from the Lebanon. The three EU countries were careful not to openly criticise Russia's heavy-handed approach to the problem in Chechnya.

The three countries cannot replace Russia's institutional relation with the European Commission, but the more contact it has with influential EU member states the securer it probably feels in dealing with the Commission. The former communist countries that joined the EU last May are a lot more reticent about dealing with Moscow.

*Cuban foreign minister visits Madrid but cedes no ground on dissidents*

Felipe Pérez Roque, Cuba's foreign minister, was given red-carpet treatment when he visited Madrid but, to the disappointment of the government, did not make any offers to release more imprisoned dissidents.

European Union foreign ministers agreed in January to temporarily restore normal diplomatic relations with Cuba, a move spearheaded by Spain. This ended a freeze on high-level contacts imposed by the EU after Havana cracked down on dissidents in March 2003 (see *Inside Spain*, Newsletter 9, January 12, 2005). The EU, which called on Cuba to release more prisoners, will review the situation in July.

Pérez Roque was received by King Juan Carlos and by José Luis Rodríguez Zapatero, the prime minister. He invited the king to pay an official visit to Cuba and said that Fidel Castro wanted to attend the Latin America summit in Salamanca in November.

When asked about the jailed dissidents, Pérez Roque said they had been justly condemned and that 'in Cuba, as in Spain, prisoners are released by the courts not by the government'.

*Spain, Venezuela, Colombia and Brazil to cooperate against terrorism, drug trafficking and poverty*

José Luis Rodríguez Zapatero, Spain's prime minister, made his first visit to Venezuela for a one-day summit hosted by Hugo Chavez, the country's embattled president, who is increasingly under attack by the US for buying arms that Washington fears could fall into the hands of rebels fighting a civil war in neighbouring Colombia.

Spain is to sell patrol boats and transport planes to Venezuela. They will not be armed and will be used to combat drug trafficking. A quarter of the cocaine exported from Colombia, the world's top producer, is transported through Venezuela, largely *en route* to Europe. Spain is Europe's largest consumer of cocaine and Europe's main port of entry for drugs. Brazil is the second-largest cocaine-using country after the United States.

Spain and Venezuela also reached an agreement for the construction and repair of ships, including oil tankers, in Spain.

Under another deal, Repsol YPF, Spain's oil and natural gas conglomerate, is to build a liquefied natural gas terminal in Venezuela and set up a joint venture with state-owned Petr6leos de Venezuela that will double its hydrocarbon reserves in the country.

Repsol controls 15% of the Yucal Placer natural gas field, a 2-billion-cubic-foot concession the company is jointly developing with France's Total and two Venezuelan companies.

### **Domestic Scene**

#### *Spanish police smash Europe's largest money-laundering ring in Marbella*

Spanish police seized 251 properties valued at €250 million, among them two entire housing developments, 42 luxury cars, including Porsches and Rolls-Royces, two aircraft and a yacht, in the largest-ever crackdown on a money-laundering ring in Europe.

The seizure of the assets, code-named Operation White Whale, and the arrests of more than 40 people, followed a 10-month investigation. Some of the laundered money is believed to have been siphoned off from the Russian oil company Yukos. Russian citizens were among those arrested, as well as Spaniards, French, Algerians, Moroccans, Finns and Ukrainians.

The laundering operation, according to the police, was run from a law office in Marbella headed by a Chilean citizen who has lived in Spain for 20 years. It was the first time police established a direct link between organised crime and Spain's booming construction and property industries, a significant part of which is being fuelled by 'black money'. According to the Bank of Spain, one-quarter of the total number of 500-euro notes circulating in the 12 countries of the European Union is in Spain. These notes are hardly ever seen in normal transactions (many shops refuse to take notes of more than €50) and yet their number has more than doubled in Spain since 2003 from 30 million to 72 million.

Candido Conde Pumpido, the attorney general, says Operation White Whale is 'the tip of the iceberg'. 'We are witnessing the silent invasion of mafias on our coast', he said, 'and the big fish have yet to be caught'. Jesus Gil y Gil, the former mayor of Marbella, was being investigated on 15 counts of corruption and links to Italian and Russian mafia bosses when he died last year. The British press has long dubbed the Costa del Sol, the Costa del Crime.

Conde Pumpido's insinuation that Gibraltar was not co-operating with Spain and the international community in fighting money-laundering drew a swift response from the British Embassy in Madrid which took the rare step of issuing a press statement. Spain has a three-century-old sovereignty claim on Gibraltar. The Embassy said the UK government had received no official request from the Spanish government for information that linked Gibraltar to the Operation or to any other specific money-laundering case. The statement also said that London had received no complaint from the Spanish government regarding the lack of co-operation by the UK or Gibraltar governments.

### **The Economy**

#### *BBVA seeks control of Italy's BNL*

Banco Bilbao Vizcaya (BBVA), Spain's second largest bank, faces an uphill battle in its €6.4 billion bid for Banca Nazionale del Lavoro (BNL), Italy's sixth biggest bank. If successful, it would be the first foreign take-over of an Italian bank and make BBVA Europe's sixth largest bank by market capitalisation. Its arch-rival Santander acquired Britain's Abbey National last year (see *Inside Spain*, Newsletter 7, November 4, 2004).

BBVA owns 14.75% of BNL but control 28% through agreements with other shareholders. It is meeting fierce resistance, however, from shareholders who own 24% of the bank. BBVA is seeking to acquire at least 50% of BNL.

BBVA said BNL represented a 'strategic fit' among its considerable assets in Spain, Portugal and Latin America 'not only for the geographic proximity and cultural affinities with the Spanish market, but also because of, and above all, the implicit potential of the Italian banking sector'.

#### *Telefónica wins control of Czech Republic's Cesky telephone company*

Telefónica, the world's third-largest telecommunications group by market capitalisation, won the bid for the Czech state's 51% stake in Cesky Telecom with a €2.7 billion offer. The deal hung in the balance because the minority government faced an opposition vote of no-confidence, but it was expected to go through because of the high price paid and the bad image it would create if the new government rejected it.

The acquisition marked a new departure for Telefónica, most of whose international investments are in Latin America.

#### *Metrovacesa launches €5.5 billion bid for France's Gecina*

Metrovacesa's €5.5 billion bid for Gecina is aimed at creating the largest property company in continental Europe. It follows the take-over in 2004 by its rival Inmobiliaria Colonial of Société Foncière Lyonnais, a Paris property group, for €1.6 billion.

Gecina's market capitalisation is half that of Metrovacesa and its move reflects the confidence of the Spanish real estate sector, which has been enjoying a 10-year boom. With the Spanish property market beginning to cool a little, however, companies are keen to enter new markets and decrease their exposure to the cyclical business of development.

*New OECD report on Spain highlights future challenges*

Spain has to overcome three main challenges if it is to continue to make further progress in real convergence with the euro area's living standards, according to the new OECD report on the country. Spain's standard of living differential with the euro area average shrank from 20 points to less than 13 between 1995 and 2004.

These reports are issued every two years and this is the first one since the Socialists took office a year ago (see [www.oecd.org/dataoecd/10/58/34571158.pdf](http://www.oecd.org/dataoecd/10/58/34571158.pdf) for a policy brief).

Eliminating the remaining gap depends on: (a) preserving macroeconomic stability and competitiveness –this requires eliminating the persisting inflation differential with the euro area, stabilising the housing market and stemming the sharp rise in household borrowing–; (b) boosting productivity gains which were very weak over the last few years; and (c) guaranteeing the financial viability of public finances. Because of the decentralised institutional framework, this involves improving budgetary relations between the different levels of government so as to limit pressures on public spending. It will also be necessary to ensure the viability of government accounts in the face of population ageing.

The report looks at several areas, including:

- **Raising productivity growth, while maintaining strong job creation.** Since the mid-1990s, employment has expanded at a remarkable pace, while the unemployment rate declined from its peak in the early 1990s to about 10.5% at the end of 2004, although this is still one of the highest rates in the OECD. Several interrelated factors have underpinned strong job creation, including very favourable monetary conditions and the arrival of a large number of immigrants, who have mostly taken jobs in a few low productivity sectors. Labour market reforms have also played a role, especially those implemented in 1997 that lowered severance payments and social security contributions for some workers. But labour market institutions, including employment protection legislation, active labour market policies and unemployment benefits, still require comprehensive reforms to push unemployment down further, while fostering a better productivity performance. Reforms of the education system and firm training, and the promotion of business R&D activities are also essential to improve productivity.
- **Getting the most out of public sector decentralisation.** In about two decades, Spain was transformed from one of the most centralised countries to one of the most decentralised. Spending functions were devolved rapidly. The regions have exercised their discretionary powers quite extensively and innovative policies have been implemented. But devolution was also accompanied by a hike in public employment and pressures on public spending, reflecting duplication in resources and poor coordination across and between government levels. The recent devolution of taxing powers could raise the accountability of the regions and, thus, cost-consciousness, although their effective use has been limited. Securing fiscal discipline requires better information on sub-national governments' policies and outcomes so as to allow citizens to press for improved performance. The financing system of the regions also needs to be reformed to ensure sustainability in the face

of changing demographics, while the fiscal rules need to be upgraded to avoid recourse to off-budget operations.

- **Reforming the pension system.** Like the other OECD countries, Spain will be faced with population ageing. The consequences were analysed in detail in the 2001 Economic Survey. It concluded that a reform of the public pension system, including a lowering in the generosity of the parameters underlying pension calculations, was needed to guarantee the long-term financial viability of the system. Since then, demographic prospects have been affected by the surge in immigration. Also various studies have been published, including official ones, suggesting that the scale of the challenge to the public finances may be less critical than had been thought. The OECD takes stock of the situation and discusses the role that could be played by various measures that aim at increasing the employment rate for women and older workers and by a fiscal policy accumulating surpluses ahead of the demographic shock.

#### *Record current account deficit sets off alarm bells*

Spain's current account deficit reached a record of €39.5 billion in 2004, almost double that of 2003 and representing more than 5% of GDP. The deterioration in this account, which measures a country's balance of trade and services (including tourism) and private and official transfers, to some extent reflects the country's loss of competitiveness and structural imbalances.

#### *Spain stands still in international IT index*

Spain was ranked 29<sup>th</sup> out of 104 countries in the 2005 'Networked-readiness' index drawn up by the World Economic Forum, the same position as in 2004. While Spain remains a laggard in IT amongst developed countries, its position is a lot better than that of Italy, which dropped 17 places in the ranking to 45<sup>th</sup> place (see Figure 1).

The index comprises many components. Spain's worst scores were in ease to start a new business, effectiveness of judiciary, government prioritisation of ICT and government success in ICT promotion.

**Figure 1. 'Networked-readiness' Index**

<b>Country</b>	<b>Networked-readiness Index, 2004-05</b>	<b>Networked-readiness Index, 2003-04</b>
Singapore	1	2
Iceland	2	10
Finland	3	3
Denmark	4	5
United States	5	1
Sweden	6	4
Hong Kong	7	18
Japan	8	12
Switzerland	9	7
Canada	10	6
Australia	11	9
United Kingdom	12	15
Norway	13	8
Germany	14	11
Taiwan	15	17
Netherlands	16	13
Luxembourg	17	14
Israel	18	16
Austria	19	21
France	20	19
New Zealand	21	23
Ireland	22	22
United Arab Emirates	23	-
Korea	24	20
Estonia	25	25
Belgium	26	24
Malaysia	27	26
Malta	28	27
<b>Spain</b>	<b>29</b>	<b>29</b>

Source: Global Information Technology Report 2004-2005, World Economic Forum.

*Spain to lower top income tax rate*

The government's tax reform, which would be applied as of 2007, includes a reduction in the top rate of income tax from 45% to 42%. Spain's rate is currently just over two percentage points lower than EU-15 average of 47%. The new top rate would be more or less in line with that of the EU-25.