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Foreign Policy

Spain pulls troops out of Haiti...

Spain pulled its 200 troops out of Haiti despite a request by the United Nations to stay there until the country's stalled electoral process is completed. They were replaced by Uruguayan soldiers.

The government said last June it would reconsider its participation in the Brazilian-led 9,000-strong UN mission unless there was substantial progress in the disbursement of pledged funds for Haiti. The western hemisphere's poorest country has so far received only slightly more than half of the US\$1 billion promised after rebels forced President Jean-Bertrand Aristide to flee the country in February 2004.

Few analysts believe this is the real reason for the pull out. The Ministry of Defence prefers to participate in NATO operations than in UN peacekeeping operations, according to a senior UN official, and there have been 'endless quarrels' between this ministry and the Foreign Ministry (which has been very supportive of maintaining the troops in Haiti).

The UN would have liked Spain to stay until after the completion of the electoral cycle (second round of parliamentary and local/municipal elections still to be held). This led Juan Gabriel Valdés, the head of the mission, to visit Madrid in March and Kofi Annan, the UN Secretary General, to send a letter to José Luis Rodríguez Zapatero, the Prime Minister.

Although the Spanish withdrawal created operational problems and is one of the factors for putting back the parliamentary elections from April 12 to 21, the UN is grateful to Madrid as it is the only EU contributor to the United Nations Stabilisation Mission in Haiti (MINUSTAH) and thus a tangible expression of European concern for Haiti.

Offers to join EU troop deployment to the Congo

The government said it was willing to send 100 soldiers to the Congo as part of an EU deployment to support UN peacekeepers during elections in June in the central African country.

The 1,500 force, led by Germany and including troops from Poland and France, would limit its stay to four months.

May increase its contingent in Afghanistan

Spain may increase the number of its peacekeeping troops in Afghanistan by around 200 to close to 800.

The increases would probable occur at Qal'eh Now and Herat in the western part of the country where Spain leads two provincial reconstruction teams (PRT), under the auspices of Nato, and at Kabul.

There is an ongoing debate about setting up a composite Nato command to take over from the UK-led Allied Rapid Reaction Corps (ARRC), rather than the Spanish-led command which had been mooted. A UK diplomat on the spot said it was better to establish a continuous composite command into which nations could feed and rotate instead of rotating national leads.

Both this mission and the one to the Congo need the approval of Spain's parliament under the new National Defence Law.

Spain may launch a volunteer corps for Latin America

Spain is planning to establish a volunteer service for Latin America modelled somewhat on former John F. Kennedy's Peace Corps which would fight underdevelopment.

The plan, still on the drawing board at the Foreign Ministry, is being coordinated with Enrique Iglesias, the former President of the Inter-American Development Bank (IBD) and now the head of the Madrid-based and recently created Ibero-American summits organisation which is preparing a programme to increase student exchanges across Latin America, Spain and Portugal.

Spain has become a major private-sector investor in Latin America over the last decade; the region is making a growing contributing to companies' profits. For example, Latin America provided almost one-third of Grupo Santander's total attributable income in 2005. Meanwhile, the two-year old Socialist government increased foreign aid to Latin America from US\$400 million in 2004 to US\$600 million in 2005 and plans more than US\$700 million this year. The government is committed to doubling its global foreign aid to 0.5% of GDP in 2008. The Observatory for Latin American Companies, headed by Miguel Sebastián, the chief economic advisor to José Luis Rodríguez Zapatero, the Prime Minister, keeps a close watch on the pulse of the region's economy.

Although not apparently an expressed aim, a volunteer service could help Spain improve its image in Latin America and show that the 'mother country' is not just interested in acquiring segments of the region's economies and becoming 'new conquistadores' in the words of the UK and US media. Anti-foreign investor sentiment is on the rise in some Latin American countries, such as Venezuela and Bolivia, and leftist governments are gaining ground in the region (Venezuela, Bolivia and possibly Peru and Mexico if Ollanta Humala and Andrés Manuel Lopez Obrador respectively win the upcoming presidential elections).

Foreign Minister on official visit to China

Miguel Ángel Moratinos, the Foreign Minister, made a four-day visit to China as a guest of his counterpart Li Zhaoxing. The visit came four months after Spain and China signed a strategic alliance agreement during the visit of President Hu Jintao to Madrid (see *Inside Spain*, Newsletter 19, December 2, 2005).

China is Spain's fifth largest supplier after Germany, France, Italy and the UK, but only 0.3% of China's imports come from Spain. Spain's exports to China in 2005 amounted to €1.5 billion, while imports from that country were worth €1.6 billion.

In a bid to increase Spain's exports to and investment in China, the government will make available €710 million to Spanish companies in 2005-2007.

Domestic Scene

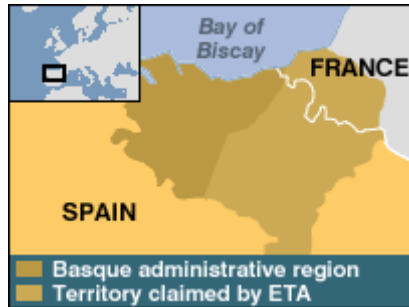
Eta declares permanent ceasefire after 38 years of fighting for Basque independence

Spain is set to begin a long and complicated peace process, following Eta's decision to declare a permanent ceasefire. The terrorist group, which has killed more than 800 people, said it wanted to end the conflict and 'promote a democratic process in the Basque country.... in which our rights are recognised'.

Every Spanish Prime Minister since the restoration of democracy after the death of General Franco in 1975 has sought to enter the history books as the person who achieved lasting peace in the Basque Country, but none was successful. The attempts at peace negotiations under Felipe González in 1989 in Algiers and José María Aznar in 1999 in Switzerland got nowhere. José Luis Rodríguez Zapatero probably has a better chance than his predecessors because Eta has been substantially weakened by the arrest of more than 400 people in Spain and France since 2003 and the discovery of ample arms caches. The group has been heavily infiltrated by Spanish intelligence agents. Also, the outlawing of Batasuna, Eta's political wing, in 2002 has reduced its political influence in the Basque Country as it is banned from fielding candidates in elections.

Eta declared an 'indefinite', as opposed to a 'permanent', ceasefire in 1998 but peace talks broke down and the bombing campaign resumed a year later. It has not killed anyone since 2003 (see the timeline below).

ETA TIMELINE



Source: The BBC.

- 1959: Eta founded
- 1968: Eta kills San Sebastian secret police chief Melitón Manzanas
- 1973: PM Luis Carrero Blanco assassinated
- 1978: political wing Herri Batasuna formed
- 1980: 92 people killed in bloodiest year
- September 1998: indefinite ceasefire
- November 1999: end of ceasefire, followed by more bomb attacks in January and February 2000
- December 2001: EU declares Eta a terrorist organisation
- March 2003: Batasuna banned by Supreme Court
- May 2003: two police killed in Eta's last deadly attack
- November 2005: 56 alleged Eta activists on trial in the largest prosecution of its kind

Eta's statement, read out by a woman in a mask wearing a black Basque beret, made no mention of handing in weapons or putting an end to the extortion of businessmen, something that made Zapatero, who last month heralded the 'beginning of the end of Eta', greet the declaration very cautiously. He expressed the hope that he could 'count on all political parties in this matter. Where before we were united in shock, I hope we are now united in hope'.

The centre-right Popular Party (PP) has made the Socialists' anti-terrorist policy the focal point of its permanent state of confrontation with the government: two years after the Madrid train bombings, which killed 192 commuters, the PP and the Socialists continue to blame one another for misleading the public and mishandling the aftermath of the March 11 attacks. The PP accuses the government, the police and the judiciary of a conspiracy to cover up alleged links between Islamic radicals and Eta, something which investigating magistrates vehemently say did not exist. The PP lost the elections three days later amidst accusations of trying to extract electoral advantage –by blaming Eta– from the national tragedy.

The PP leader, Mariano Rajoy, said his party was prepared to back the government if it did not pay a 'political price' for defeating terrorism. He warned the government not to be hoodwinked by the 'pause in Eta's criminal activities'. Last May, parliament voted to authorise negotiations with Eta if the group declared an unconditional and permanent end to violence but without the votes of the PP, which accused the government of 'betraying the dead' and sending the wrong signal to Eta (see *Inside Spain*, Newsletter 14, June 6, 2005). Squabbles between the two parties could derail a peace process.

Eta is not in a position to drive a hard bargain with the government, and there is very little that Madrid has to offer. Eta did not explicitly speak of the right of self-determination in its statement, but this is what it hints at and will not get. Last year

parliament rejected by 313 to 29 votes the plan presented by the region's long ruling centre-right Basque Nationalist Party (PNV) for an 'associated free state' between the Basque Country and the rest of Spain which could have opened the door to independence (see *Inside Spain*, Newsletter 10, February 7, 2005). The PNV has never really distanced itself sufficiently from Eta: according to a much-quoted remark of Xabier Arzallus, one of the key PNV politicians of the past 30 years, 'Eta shakes the tree and we will pick up the nuts'.

The Basque Country –unlike Northern Ireland at the start of the IRA's peace talks– already enjoys a very high degree of home rule, with its own parliament, taxes, healthcare and education systems and police force. One concession it could make would be to allow the 544 convicted Eta prisoners in Spain to serve their sentences in Basque jails. They are currently dispersed around the country, which makes visits from family members more difficult. There are also around 200 Eta prisoners in France. The issue of reinsertion of prisoners is very sensitive, particularly for the victims of Eta's terrorism.

Parliament gives green light to new Catalan autonomy statute

The Spanish Congress approved the new controversial charter giving greater autonomy to Catalonia. The text was a watered-down version of that presented to the national parliament by the Catalan parliament last year (see *Inside Spain*, Newsletter 18, November 3, 2005).

The statute, which gives Catalonia wider tax-collecting and judicial powers, was approved by 189 to 154. The centre-right Popular Party (PP) voted against it, as did the much smaller Republican Left of Catalonia which favours independence.

'It's the beginning of the end of the state Spaniards drew up in 1978', said Mariano Rajoy, the PP's leader, referring to the year the Spanish Constitution was approved.

The charter has to be approved by the Senate and by the Catalan parliament before being put to the vote in a referendum in the region.

Government to dissolve Marbella town hall after mayor arrested

The government decided to dissolve the Marbella town hall after the mayor and three town councillors were imprisoned on charges of corruption and profiteering from the property boom in the Mediterranean resort.

Marisol Yagüe is the second Marbella mayor to be arrested for alleged town planning violations. Her predecessor, Julián Muñoz, was barred in 2005 from holding public office for eight years. More than 20 people face possible charges including laundering money from real estate developers who allegedly paid large sums for building permits. Police seized or embargoed more than €2.4 billion in property, helicopters, thoroughbred horses, artwork and antique guns.

Marbella's most prominent mayor, the late Jesús Gil, was indicted numerous times in the 1980s and 1990s on corruption charges, many dealing with real estate fraud in the resort, a favourite haunt of the jet set.

Spain seeks to stem the wave of migrants from Mauritania

The Spanish and Mauritanian governments held crisis talks after more than 1,000 West Africans reached the shores of the Canary Islands in flimsy boats, following a perilous 300-mile journey.

As a result of tougher police action and border patrols in Morocco, Mauritania has become the latest launch pad for Africans trying to reach Europe. In one incident, a Spanish marine hospital boat found the bodies of 24 people in waters off the coast of Mauritania. According to one estimate only 60% of those who brave the crossing make it alive.

Sidi Mohamed Uld Bubakar, Mauritania's Prime Minister, met with a Spanish delegation and told them his government could not cope with the influx of people from other countries, particularly Senegal and Mali, using Mauritania as a staging post for reaching Europe. The Canary Islands is also increasingly stretched by the arrival of migrants.

Spain has offered Mauritania patrol boats and funds to set up reception centres. A team of 35 Spanish military engineers went to Mauritania to help set up a centre for repatriated immigrants.

Between 1999 and February 2006, 5,715 boats containing illegal migrants were detected and 103,126 people detained, mostly after crossing the Strait of Gibraltar.

Government plans to cut more than 3,000 jobs at state-run TV

The government plans to cut 3,133 jobs at RTVE, the heavily indebted state-run TV and radio company. The move follows other reforms approved last year including the assumption by the state of the €7,560 million debt and the appointment by parliament, not the government, of RTVE's director. Privatisation has been ruled out, but the government has made it clear that RTVE has to be commercially viable and stand on its own feet.

RTVE's debt soared from €133.7 million in 1991 to €7,560 million at the end of 2005, while the number of employees dropped over the same period from 12,849 to 9,212.

According to Jaime Gaitero, RTVE's Secretary General, it is twice as expensive for RTVE to produce an hour of television than the privately-owned channels Antena 3 and Tele 5.

Unions strongly oppose the cuts and the government probably has a battle on its hands. Previous governments have attempted and failed to get to grips with RTVE.

The Economy

Heated battle for the take-over of Endesa

The protracted and politicised battle to take over the energy group Endesa intensified when the European Commission called on the Spanish government to respect its sole right to scrutinise and approve pan-European deals such as the one proposed by Germany's Eon.

Eon's €29 billion bid for Endesa, Spain's largest producer of electricity, tops that of Spain's Gas Natural, the candidate favoured by the government as it would create a national champion. The Commission's competition directorate is worried about a recently approved decree law that gives Spain's national energy commission powers to veto or impose conditions on take-overs of domestic utilities in order to protect the 'national interest' when 'strategic assets' are concerned.

Madrid is also under attack from the EU internal market directorate which believes the government's position may have breached EU rules on the free movement of capital.

Pedro Solbes, Spain's Economy Minister and a former EU Monetary Affairs Commissioner, justified the changes to the energy commission on the grounds that the legislation regarding national interest or security was 'excessively imprecise'.

Meanwhile, Endesa won a small reprieve when a Madrid court ordered a suspension of Gas Natural's €2 billion bid pending a definitive ruling on whether or not a side agreement between Gas Natural and Iberdrola, Spain's second-biggest generator, contravened European Union rules on fair competition. Endesa agreed to post the €1 billion guarantee required by the court as a condition against any potential damages incurred during the case. Gas Natural appealed against the ruling.

Gas Natural has an agreement with Iberdrola to sell up to €9 billion of assets which would eliminate possible regulatory hurdles to its take-over bid and obtain financing for the deal.

Spain makes its first major investment in India

Roca, the Spanish bathroom products group, reached an initial agreement to acquire 50% of India's Parryware, a subsidiary of the Indian sugar group EID Parry, for €50 million. Spanish direct investment in India is virtually non-existent.

Only 4% of Indian households have a complete bathroom.

Hard on the heels of this purchase, Roca acquired Austria's Lasselsberger, which has plants in Croatia and Rumania, and Switzerland's JohnsonSuisse, whose plant is in Malaysia. The total cost of these investments was more than €50 million. Roca sells its products in more than 80 countries.

UK airports operator rejects Ferrovial's take-over bid

BAA, which operates seven airports across Britain including Heathrow and Gatwick, rejected Grupo Ferrovial's €12.6 billion bid. The Spanish construction, infrastructure and services group was expected to come back with a higher offer after Australian bank Macquarie joined its bidding consortium. If successful, Ferrovial would give Macquarie the option to buy its stakes in Sydney and Bristol airports.

The UK government indicated it would not oppose any change of ownership of BAA as long as a new owner was committed to the heavy investment programme.

Inward foreign investment drops 11%, outward 47%

Spain's gross inward foreign direct investment dropped 10.6% to €16.6 billion in 2005 and its gross outward investment was almost 47% lower at €26.3 billion. Both figures

include investment in Special Purpose Vehicles (ETVEs) which enjoy tax advantages and whose sole purpose is to hold foreign equity. Excluding the ETVEs, inward investment was 24% higher and outward 40.5% lower. Net inward investment was €10.2 billion and net outward €22.9 billion (see Figure 1).

Figure 1. Spain's net inward and outward direct investment, 1995-2005

Year	Inward (€bn)	Outward (€bn)
1995	3.5	2.8
1996	2.7	3.3
1997	4.0	9.0
1998	4.0	12.2
1999	13.7	43.6
2000	29.3	48.4
2001	28.9	42.1
2002	28.7	30.1
2003	14.8	25.3
2004	9.0	43.7
2005	10.2	22.9

Source: Foreign Investments Registry.

The main reason for the big drop in outward investment was not a let up in acquisitions by Spanish companies but the impact of Grupo Santander's €13.4 billion purchase of the UK's Abbey bank in 2004 on comparisons with 2005.

The main ultimate investor country in Spain excluding ETVEs in 2005 was France (45% of the total), followed by the United States (17%). The main destiny of outward investment excluding ETVEs was France (see Figures 2 and 3). The outward investment figures confirm the shift in investment from Latin America to Europe, particularly the new EU countries.

Figure 2. Main ultimate investor countries in 2005

Country	Gross Amount (€mn)	% of total
France	6,454	44.7
United States	2,461	17.1
United Kingdom	1,205	8.3
Germany	1,201	8.3
Netherlands	417	2.9
Switzerland	405	2.8
Portugal	381	2.6
Italy	295	2.0
Mexico	221	1.5
Japan	196	1.4

Source: Foreign Investments Registry.

Figure 3. Main countries receiving investment in 2005

Country	Gross Amount (€mn)	% of total
France	4,999	21.8
Czech Republic	3,671	16.0
United Kingdom	2,300	10.0
Hungary	2,187	9.5
Argentina	1,871	8.1
United States	1,363	5.9
Portugal	1,088	4.7
Luxembourg	968	4.2
Netherlands	940	4.1
Brazil	783	3.4

Source: Foreign Investments Registry.

Tax Agency has greater success in fighting fraud

The Tax Agency recovered €4,583 million in 2005, 13% more than in 2004, thanks to tougher measures, particularly in the booming real estate sector, and more inspections. Close to 3,500 real estate companies were investigated.

Despite the greater success, tax fraud and the volume of black money remain high in Spain. One revealing statistic is that the number of 500-euro notes in Spain has increased from the 13 million issued by the Bank of Spain in January 2002, when the single currency came into force, to 96 million four years later. The number of these notes in Spain represented 3.5% of the total in 2002 and almost 25% in January 2006.

IMF warning on Spain's 'lopsided' economy

The International Monetary Fund (IMF) warned that Spain's economic growth has become 'increasingly lopsided' and the underlying balances have intensified.

In its annual review of the Spanish economy, the IMF said that while growth in 2005 of 3.4% marked a decade of uninterrupted expansion and Spain created 60% of all new jobs in the euro area, the current account deficit widened to 7.5% of GDP, the second largest in absolute terms in the world (see www.imf.org/external/np/ms/2006/032106.htm).

Supported by employment and income gains, wealth effects from the real estate boom, and rapid credit expansion, domestic demand contributed 5¼ percentage points to GDP growth. The external sector, in contrast, depressed growth by almost 2 percentage points, as import penetration and the erosion of export market shares intensified in 2005. No doubt, the widening deficit reflects in part higher oil prices, weak demand in traditional export markets and Spain's rising investment. But it also reflects the steady deterioration in Spain's competitive position, in turn driven by price pressures generated by its advanced cyclical position and, more fundamentally, by lacklustre productivity growth.

The IMF said the immediate prospects remain good, but the medium-term outlook is clouded by the build-up of imbalances and competitiveness losses. In the past Spain could correct the current account deficit by devaluing its currency. But it cannot do this now as it is part of the euro. If Spanish productivity growth is not improved and labour and product markets made more flexible, the IMF warned, regaining competitiveness within the euro area would entail a 'protracted and costly process weighing on output and employment'.

The IMF praised the government for its recent tax reform, although the corporate income tax rate remains comparatively high, but it said its mission to Madrid had encountered 'dispiriting doubts' about the prospects for further reform of employment protection legislation which remains among the most restrictive in the OECD. Nothing had been achieved in the almost two years since the July 2004 declaration on *diálogo social*. It said the way to reduce the very high rate of temporary contracts (one third of salaried employees are on them) was to 'reduce the rigidity and high dismissal costs of regular contracts'.

OECD urges government to do more to combat bribery of foreign public officials
 Spain should rapidly amend its law so that companies can be found directly liable for bribing foreign public officials and sanctioned with serious fines, according to a new report by the OECD Working Group on Bribery.

The main recommendations of the OECD Working Group are that Spain should:

- Amend the law to expand the applicable penalties on companies to include dissuasive fines.
- Increase the penalties on bribery of foreign public officials to obtain favourable discretionary decisions, such as the award of a contract.
- Expand the definition of foreign bribery to include bribes composed of non-monetary benefits such as giving a job to a relative, and take action to ensure that the foreign bribery offences in Spain do not require the interpretation of any foreign law for their application.
- Improve the flow of information to prosecutors and judges about possible foreign bribery by Spanish companies.
- Make explicit the prohibition on the tax deductibility of bribes to foreign public officials.

Three Spanish companies among Forbes 100 largest

Santander, BBVA and Telefónica are among the world's 100 largest companies, according to the latest ranking of *Forbes* magazine based on a composite score for sales, profits, assets and market value (see Figure 4). Santander moved from 46th to 19th position as a result of its acquisition of the UK bank Abbey in 2004. Spain has 29 companies in the total list of 2,000, which is headed by Citigroup (see www.forbes.com/lists/2006/18/Country_11.html).

Figure 4. Ranking of Spanish companies in the Forbes list*

Positions 19-479	Positions 490-837
19. Santander	490. Gas Natural
58. BBVA	502. Altadis
76. Telefónica	560. Unión Fenosa
129. Repsol YPF	657. Inditex
141. Endesa	713. FCC
225. Iberdrola	727. Banco Sabadell
409. Banco Popular	741. Sacyr Vallehermosa
445. ACS	773. Mapfre
466. Ferrovial	834. Acciona
479. Cepsa	837. Abertis

(*) In the top 1,000.
 Source: Forbes.