

## **Inside Spain 14**

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### **Foreign Policy**

#### *Spain Might Send More Troops to Afghanistan*

The government is to seek parliamentary approval to double the number of soldiers it has in Afghanistan. The troops, requested by Nato, would maintain public order during September's elections.

Spain sent a battalion to Afghanistan for two months last autumn for the presidential election and in February agreed to move 540 troops from Kabul, the capital, to the more conflictive western part of the country, enabling Nato to play a greater pacification role and the government to mend some bridges with the United States following the abrupt withdrawal last year of peacekeeping troops in Iraq.

The Netherlands and Rumania have already agreed to contribute troops for the September parliamentary elections and one more battalion is needed. The elections will be the first real test of power in Afghanistan since the overthrow of the Taliban regime.

The request for parliament's approval follows a pledge by José Luis Rodríguez Zapatero, the prime minister, that troops would never again be sent on foreign missions 'behind the backs of its citizens'. This was a thinly veiled attack on José María Aznar, his predecessor, who committed 1,300 troops to Iraq in 2003 after the US-led invasion without seeking parliament's approval, although his party had an absolute majority.

Zapatero said the Spanish flag had become 'a symbol of peace' since his election and that 'Spanish soldiers are where the Spanish want them to be'.

Meanwhile, Spain has agreed to participate with German and French troops in two of the 13 rapid intervention forces that the EU wants to have in place by 2008. Each force will have around 1,500 soldiers.

José Bono, the defence minister also said Spain was willing to contribute to the pacification of the Sudanese region of Darfur. It will provide two CASA 212 transport aircraft and military advisors. The pacification operation is backed by the UN and involves soldiers from African countries.

Spain has participated in 60 peace-keeping missions over the last 25 years and has sent more than 50,000 troops abroad. There are currently troops in Bosnia, Afghanistan, Haiti and Kosovo. According to a Pentagon report to the US Congress, Spain is the sixth country in supplying naval forces abroad and the third in infantry.

*French No vote, a setback for Spain*

France's rejection of the European Union constitution is a particular blow for José Luis Rodríguez Zapatero. Spain was the first country to approve the constitution in a referendum, Zapatero campaigned in France for a Yes vote and France, together with Germany, are the core elements of the Socialists' more pro-European and less Atlanticist foreign policy.

Zapatero, however, said the ratification process was not dead until all member states had had their say. Nine member states, representing half the EU's citizens, have so far ratified the constitution. 'Europe is not the problem, it is the solution', he said, echoing José Ortega y Gasset's much quoted remark of 1911, 'If Spain is the problem, Europe is the solution'.

The centre-right Popular Party, which supports the constitution, seized on the French rejection to criticise Zapatero for 'backing the losing team'.

The Socialists, before the French rejection, were optimistically hoping that a deal would be struck at the June 16-18 EU summit in Luxembourg over how EU funds would be carved up for the 2007-13 period, but this now looks even more doubtful in the current crisis situation. Spain is still the largest net recipient of EU funds, which amount to around €6 billion a year, or just under 1% of GDP. The rich EU countries are pressing for Spain to become a net contributor while the Socialists are battling not to reach this position until 2013.

Luxembourg, the current president of the EU, recently accepted, in principle, that Spain should be given a two-year transition phase because of the so-called 'statistical effect'. The enlargement of the EU from 15 to 25 members pushed up Spain's per capita GDP from 87% of the EU-15 average to 95% of the EU-25 average, thereby disqualifying the country as a whole from receiving Cohesion Funds as the threshold for them is 90%. Eleven of Spain's regions also receive Structural Funds (where the qualifying threshold is per capita income below 75% of the EU average). Most of these regions will cease to receive the funds.

The chances of Spain achieving what it wants are slim, particularly if the big net budget contributors –Germany, the Netherlands, Britain, France, Austria and Sweden– succeed in reducing the amount of funds available to 1% of the Union's GDP from 1.24% (the European Commission's proposal).

On the positive side, the French rejection, coupled with Gerhard Schroeder's decision to call early elections and Silvio Berlusconi's domestic political problems, leaves Zapatero (and Tony Blair) heading one of the few governments among the large EU nations that has not been damaged. This is an opportunity for Spain to boost its standing.

The unknown factor is whether Zapatero will support Blair's idea that the big issue that has emerged from the French rejection is the need for a more competitive Europe, and

hence reforms, to kick start the stagnant economy and tackle the challenges of globalisation rather than a more 'social' Europe. Many of those who voted No in France did so because they wanted a more protectionist, corporatist Europe. The UK –whose economy is one of the more successful in the EU– takes over as the EU president in July.

### **Domestic scene**

#### *Parliament approves talks with Eta if it lays down its arms*

The Spanish parliament voted in favour of allowing the government to hold talks with the Basque terrorist group Eta if it first abandons its arms and renounces violence. This was the first time a government had sought and received approval on this issue from parliament since Eta took up arms more than 30 years ago. Eta has assassinated more than 800 people in its struggle for an independent Basque country, but none since 2003.

The move was fiercely opposed by the Popular Party, which accused the government of 'betraying the dead' and sending the wrong signal to Eta which is greatly weakened as a result of the security forces' success in capturing Eta members and arsenals of weapons. A poll in the newspaper *El País* showed that 61% of Spaniards favoured talks with Eta if it laid down its arms. There have been previous attempts to negotiate with Eta, but none of them got very far. The last attempt was in 1999, during a 14-month truce.

The ruling Socialists, emboldened by their gains in the Basque regional elections last month (see *Inside Spain*, Newsletter 13, May 10, 2005), see a window of opportunity to resolve the issue once and for all, but it is a high-risk strategy. They have little to offer Eta beyond better conditions for several hundred prisoners from the group in Spanish and French jails. An independent Basque country is not on the negotiating table. Indeed, the plan of the Basque National Party (PNV), in power in the region since 1980, for an 'associated free state' with Spain was rejected by the Spanish parliament earlier this year.

Despite what is regarded in some circles as an 'informal truce', Eta has not stopped its campaign of violence: 52 people were slightly injured recently when a bomb damaged buildings and vehicles in Madrid.

The government also vowed there would be no let-up in counter-terror operations. Arnaldo Otegi, the leader of the outlawed Batasuna party, the political arm of Eta, and a former member of the Basque regional parliament, was charged with being a member of the armed group. He spent 40 hours in solitary confinement until his supporters were able to raise the €400,000 bail. Otegi lost immunity from prosecution in May when he stopped being a member of the regional parliament. A Batasuna spokesman said Otegi's arrest had 'slammed the door on the hopes for peace of the Basque people'.

### **The Economy**

#### *Spain is richer than it thought*

Spain's gross domestic product in 2004 has been revised upwards by almost €40,000 million to €837,557 million, largely thanks to the inclusion of around 1 million more jobs, mostly held by immigrants. The new figures drawn up by the National Statistics Office (INE) underscored the increasingly significant role that immigrants are playing in the economy. Last month close to 700,000 illegal immigrants benefited from a

government amnesty that enabled them to regularise their situation (see *Inside Spain*, Newsletter 13, May 10, 2005).

Per capita income, however, remained largely unchanged at €19,642 because of the revised population figure (42.6 million as against 41 million). The economy grew 3.1% in 2004, 0.4 points higher than the initially estimated 2.7% and a full point more than the EU-25 average, and by an annual rate of 3.3% in the first quarter of 2005.

The greater wealth, however, weakens Spain's bargaining position with the enlarged EU over how Structural and Cohesion Funds from Brussels will be carved up for the 2007-13 budgetary period.

Spain is richer, but its citizens are also heavily in debt. For the first time in recorded history, Spaniards' total household debts in 2004 exceeded their disposable income. The debt represented 105% of income. The greater indebtedness was largely due to the 24% surge in mortgages as people try to get a foot on the increasingly expensive property ladder.

*Spain slips seven places in the IMD competitiveness ranking*

Spain's economy is booming but the country fell from 31<sup>st</sup> to 38<sup>th</sup> position out of 60 nations in the latest competitiveness ranking of the IMD, the sharpest fall the country has experienced from one year to the next (see Figure 1). The ranking, which put Spain just ahead of India and behind Hungary, confirmed the worst fears of the one-year-old government which has made improving competitiveness one of the central planks of its economic policy. Since 2001, Spain has declined 14 places.

**Figure 1. Competitiveness Factors\***

	2005	2004	2003	2002	2001
Economic performance	25	22	24	19	30
Government efficiency	30	22	24	22	20
Business efficiency	48	38	31	29	26
Infrastructure	33	31	28	25	23
Overall performance	38	31	27	23	24

(\*) Ranking out of 60 countries.

Source: IMD World Competitiveness Yearbook 2005.

The country declined in all four of the competitiveness factors, particularly in government and business efficiency. One of its weakest elements is the number of days to start a business, where Spain was ranked 52<sup>nd</sup>. According to the World Bank, the average in Spain is 108 days.

Catalonia is the only Spanish region to be included separately in the IMD study. It slipped from 27<sup>th</sup> to 32<sup>nd</sup> position, ahead of Ile de France and Rhone-Alps, two of the other regions included.

The IMD report coincided with the OECD's review of economies which urged Spain to reduce its high inflation differential with the Euro zone to stem the loss of competitiveness. It said that 'the persistence of a sizeable inflation differential with the euro area and a boom in the housing market represent the two most important risks threatening the dynamism of the economy over the medium term'. The OECD's forecasts for GDP growth are a little on the low side as they do not take into account the restated figures for 2004 (see Figure 2).

**Figure 2. OECD Forecasts for the Spanish Economy (% change over previous year)**

	2004	2005	2006
Private consumption	3.5	3.5	3.5
Gross fixed capital formation	4.6	6.1	5.4
Net exports*	-1.7	-1.4	-1.1
Real GDP	2.7	3.0	3.2
CPI	3.1	3.1	2.6
Unemployment (% of labour force)	10.8	10.2	9.8
Gen. government balance (% of GDP)	-0.3	0.5	0.6

(\*) Contribution to change in real GDP.

Source: OECD.

### *Bank of Italy raises the conditions for BBVA's take-over of BNL*

The Bank of Italy has given its blessing to BBVA's €6.4 billion bid to take over Banca Nazionale del Lavoro, the country's sixth largest bank, but only if it acquires at least 50% of BNL's shares. BBVA already owns close to 15% of the bank. The European Commission regards this condition as unacceptable and asked the Bank of Italy to justify its conduct.

Neelie Kroes, the European Union competition commissioner, told *El País* in an interview: 'I am very surprised, to put it diplomatically, that the Bank of Italy would demand of BBVA that it have at least 50% of the shares. I don't believe that is acceptable. It's very strange that a central bank acts this way. It must explain itself, because I don't know what the reason is for this attitude and I am not going to tolerate any attempt by the Bank of Italy to unfairly block a deal like this one.'

Meanwhile, BBVA cleared another hurdle when it maintained control of BNL's board. Italian insurer Unipol raised its stake to 5% and was seeking permission from the Bank of Italy to go higher, but denied it was preparing a counter-offer. The Dutch ABN Amro is also seeking to become the first foreign bank to take over an Italian bank, in its case Antonveneta.

### *Repsol YPF in massive drive to boost oil and gas reserves*

Repsol YPF is to invest €21 billion over the next five years, more than half of which will be used to boost its dwindling reserves of oil and natural gas. The focus will be exploration and development in northern and western Africa, the Caribbean and the Middle East.

The aim is to boost current production of hydrocarbons by 13.6% to 1.3 million barrels equivalent a day by 2009, while reserve replacement rates would be almost doubled to 60%.

### *Single Iberian electricity market postponed yet again*

The start-up of the single electricity market for Spain and Portugal, scheduled for June 30, has been postponed for the third time. The market was agreed in November 2001 with an original start-up date of January 2003. It would be Western Europe's fifth-largest power market after Great Britain.

The problems that still have to be resolved include the stranded costs recovery framework for Portugal and the limited capacity of the interconnections between the two countries. Spain is currently drawing up a White Book on electricity generation.